BUDGET DEFICIT PROBLEM AND ITS IMPACT ON THE TRNC ECONOMY

ENGİN ARI

EASTERN MEDITERRANEAN UNIVERSITY

1999

EASTERN MEDITERRANEAN UNIVERSITY

INSTITUTE OF RESEARCH AND GRADUATE STUDIES

BUDGET DEFICIT PROBLEM AND ITS IMPACT ON THE TRNC ECONOMY

A MASTER'S THESIS
BY
ENGİN ARI
FOR THE DEGREE OF MASTER OF SCIENCE
IN
ECONOMICS

GAZIMAĞUSA September, 1999

BUDGET DEFICIT PROBLEM AND ITS IMPACT ON THE TRNC ECONOMY

by

Engin ARI
September, 1999

Dissertation submitted to Eastern Mediterranean University in partial fulfillment of the requirements for the degree of Master of Science in Economics

EASTERN MEDITERRANEAN UNIVERSITY
FACULTY OF BUSINESS AND ECONOMICS

Thesis Title : Budget Deficit Problem and Its Impact on the TRNC Economy.

Submitted by : Engin ARI

Department : Economics

Approval of the Institute of Research and Graduate Studies.

Assoc. Prof. Dr. Zeka MAZHAR
(Head of the Institute)

I certify that this thesis satisfies all the requirements as a thesis for the degree of Master of Science.

Prof. Dr. Ahmet YÖRÜKOĞLU
(Head of Economics Department)

Thesis Examining Committee

Prof. Dr. Ahmet YÖRÜKOĞLU
(Supervisor)

Assist. Prof. Dr. Danbala DANJU

Assist. Prof. Dr. Abdul GHAFOOR

Acknowledgements

I would like to express my deep gratitude to Prof. Dr. Ahmet Yörükoğlu for his self-sacrificing supervision and encouragement throughout this study. I also would like to thank Dr. Hasan A. Bıçak for his support. I am grateful to Mr. Ahmet Z. Bulunç for his continuous motivation as well as for his intellectual help. My sincere thanks are due to Mr. Birol Betoncu, Mr. Cevdet Başaran, Ms. Fatma Kınış and Ms. Hayriye Sonuvar. Their help in editing the final draft added a lot to the comprehensive value of the thesis. My special thanks are also to my wife Refia Arı and to my sons Anıl and Orhan for their patience and understanding in helping me to accomplish this work. Without their help, this work could not have been done.

Abstract

The Turkish Republic of Northern Cyprus is experiencing socio-economic structural problems that have been accumulated throughout the years since its establishment. The structural problems have led to the budget deficits that create a big burden on an economy. For, a budget is not only a legal document which specifies the public expenditures, revenues and public needs, but it is also an important instrument in the realisation of planned growth and socio-economic structure in a country.

The aim of this study is to investigate the effects of budget deficits on the economy of Turkish Republic of Northern Cyprus. Factors creating the budget deficits and the methods used in financing these deficits in Turkish Republic of Northern Cyprus have been discussed in detail.

In this study, public finance of Turkish Republic of Northern Cyprus in general and the budget deficit in particular, have been evaluated. The structures of the budget and the public sector have been analysed in a time perspective and the main problems concerning public finance of the country are identified.

The effects of financing the budget deficits on the economy and the methods used in financing the deficits have been investigated from different aspects, using various methods. Theoretical concepts about financing the budget deficits and about the effects that they create on an economy have been introduced and compared with the case in Turkish Republic of Northern Cyprus.

Within the frame of this study, some policy solutions for minimizing the negative effects of budget deficits on the economy have been suggested in brief.

Abstract

Kuzey Kıbrıs Türk Cumhuriyeti kuruluşundan bu yana yıllarca biriken yapısal sosyo-ekonomik sorunlar yaşamaktadır. Bu yapısal sorunlar, ekonomi üzerinde büyük bir yük oluşturan bütçe açıklarına neden olmuşlardır. Çünkü bütçe, yalnızca kamu gelir ve giderleri ile kamusal ihtiyaçları belirleyen bir yasal doküman değil, aynı zamanda, bir ülkede planlı büyüme ve sosyo-ekonomik yapının gerçekleştirilmesinde de önemli bir araçtır.

Bu çalışmanın amacı, Kuzey Kıbrıs Türk Cumhuriyeti ekonomisi üzerinde bütçe açıklarının etkilerini araştırmaktır. Kuzey Kıbrıs Türk Cumhuriyeti'nde bütçe açıklarını yaratan nedenler ve bu açıkların finansmanında kullanılan yöntemler detaylı olarak tartışılmıştır.

Bu çalışmada, genel olarak Kuzey Kıbrıs Türk Cumhuriyeti'nin kamu maliyesi ve detaylı olarak da bütçesi değerlendirilmiştir. Bütçe ve kamu sektörünün yapıları analiz edilerek ülkenin kamu maliyesinde yaşanan sorunlar bir zaman perspektifi içerisinde tanımlanmıştır.

Bütçe açıklarının finansmanının ekonomi üzerindeki etkileri ve açıkların finansmanında kullanılan yöntemler farklı yönlerden ve değişik yöntemler kullanılarak araştırılmıştır. Bütçe açıklarının finansmanı ve ekonomi üzerinde yarattıkları etkilerle ilgili teorik kavramlara değinilmiş ve Kuzey Kıbrıs Türk Cumhuriyeti'ndeki durumla karşılaştırma yapılmıştır.

Bu çalışma çerçevesinde, bütçe açıklarının ekonomi üzerindeki olumsuz etkilerini asgari seviyeye indirmek için kısa olarak bazı politika önerileri yapılmıştır.

TABLE OF CONTENTS

LIST OF TABLES , FIGURES AND GRAPHS

Preface

In recent years there have been a lot of discussions about budget deficits. Many economists and other observers have viewed these deficits as harmful to countries' economic positions. These harmful effects include high real interest rate, low savings, and low rates of economic growth and crowding out of private sector from the investments. In this context the financing methods of budget deficits are very important aspect of economic activities as well.

The Turkish Republic of Northern Cyprus has also had a serious budget deficit problem since 1977. The structural problems, especially the high share of public sector in the economy and the consequent low level of productivity, have led to the budget deficits in the country Current expenditures, especially the personnel expenditures and transfer payments, are the main elements that create budget deficits. Losses of the Public Economic Enterprises are other problems that cause budget deficits.

The usual way of financing budget deficits is either to engage in domestic borrowing via issuance of bonds and bills or the use of money financing method. The use of short-term advances from the Central Bank is another way of domestic borrowing. Issuance of bonds and bills has not been applicable to the Turkish Republic of Northern Cyprus since the financial market is not well developed. The use of money financing method, in other words, creating new money (printing money) is not applicable either since the Turkish Lira is in circulation as legal tender. Therefore, she does not have too many alternatives for financing its deficits. Aids and borrowing from Turkey finance large portion of her budget deficits, which have never been paid back. Some domestic borrowing is done through the Central Bank as short-term advances lent to the Treasury Department of the state. The size of domestic Treasury borrowing has changed significantly since the establishment of the Central Bank.

The aim of this study is to investigate the effects of budget deficits, on the economy of the Turkish Republic of Northern Cyprus. Another aim of the study is to suggest brief policy solutions for minimizing the negative effects of budget deficits on the economy of the country.

In Chapter I, three schools of thought concerning the economic effects of budget deficits are discussed; Neo-classical, Ricardian and Keynesian. The basic structure and implications of each paradigm is summarized under financing the budget deficits by debt instead of tax financing.

In Chapter II, public sector deficit and the ways of financing this deficit is analysed in a time perspective for the period 1982-1997. Also, fiscal policy tools that are employed in the Turkish Republic of Northern Cyprus are examined in this chapter.

In Chapter III, the budget of the country has been analysed in a time perspective for the period 1977-1997. As a result of this analysis, the causes of budget deficits are identified and the financing methods adopted in the country are examined with reference to the period 1977-1997.

In Chapter IV, effects of budget deficits on the economy of the country are discussed in detail. Interest rates, balance of investments and savings, developments in fixed capital investments and the distribution of advances and rediscounts from the Central Bank's resources together with the sectoral distribution of advances, loans and bills discounted from the whole banking system are analysed in a time perspective.

In Chapter V, conclusion of the study is drawn and policy solutions for minimizing the negative effects of budget deficits on the economy of the Turkish Republic of Northern Cyprus are suggested in brief.

I. THEORETICAL APPROACHES

1. Introduction

Traditional public finance theory mainly covers taxes, public expenditures and public debt. Taxes being weightier; borrowing is the main alternative to taxes for financing the budget deficits. Too many discussions have been made about public debt and deficit financing for years. The three theoretical approaches about the subject are generally considered while discussing the economic effects of the budget deficits. These approaches are the Neo-classical approach, the Keynesian approach and the Ricardian approach.

2. Standard Neo-classical Model

The neo-classical approach to fiscal policy emphasises the microeconomic linkages among government spending, debt and tax policies and their effects on households and firms. It asserts that the scope for active fiscal policy is radically less than what the Keynesian approach suggests.[1]

The neo-classical approach focuses on households, permanent income and ability to spend. If an individual's taxes are cut now, and if the same person has to pay off the interest and principal on the debt floated to finance the tax cut, the person's permanent income does not changed. In this example, there is no reason, on permanent income grounds; to think that a tax cut will increase the person's spending.

At the aggregate level, suppose everyone believed that the national debt would eventually be paid off. At some point in the future, the government would have to run a surplus to pay off the debt. That means it would have to raise taxes in the future. Therefore, an increase in the debt would increase individuals' wealth and at the same time suggest to them that their taxes

[1] Dornbush and Fischer, **MACROECONOMICS**, 6. Ed, McGrawhill, Singapore, 1994. p.587

would be higher in the future. The net effect on aggregate demand might then be zero.[2]

The neo-classical model of the debt stresses that when the government initiates a project, whether financed by taxes or borrowing, resources are removed from the private sector.[3] One usually assumes that when tax finance is used, most of the resources removed come at the expense of consumption. On the other hand, when government borrows, it competes for funds with individuals and firms who want the money for their own investment projects. Hence it is generally assumed that debt has most of its effect on private investment. To the extent that these assumptions are correct, debt finance leaves future generations with a smaller capital stock, ceteris paribus. Its members therefore are less productive and have smaller real incomes than otherwise would have been the case.

The assumption that government borrowing reduces private investment plays a key role in the neo-classical analysis. It is sometimes referred to as the *crowding out* hypothesis- when the public sector draws on the pool of resources available for investment, private investment is crowded out. Crowding out is induced by changes in the interest rate. When the government increases its demand for credit the interest rate, which is just the price for credit, must go up. But if the interest rate goes up, private investment becomes expensive and less of it is undertaken.[4] Unfortunately, things are complicated by the fact that other variables can also probably affect interest rates. For example, during a recession, investment decreases and hence the interest rate falls. At the same time, slack business conditions lead to smaller tax-collections, which increase the deficit, Ceteris paribus.

---

[2] Ibid., p. 588.
[3] Harvey S. Rosen, **PUBLIC FINANCE**, 4. Ed, IRWIN, USA, 1995. p. 467.
[4] Ibid., p. 467.

Hence, the data may show an inverse relationship between the interest rate and deficits, although this says nothing one way or the other about crowding out. As usual, the problem is to sort out the independent effect of deficits on interest rates, and this kind of problem can be quite difficult. According to Harvey S. Rosen, author of *Public Finance*, when Miller and Roberds [1992] reviewed the econometric studies of this issue, they found conflicting results. Despite the murkiness of the econometric evidence, the theoretical case for at least same crowding out is so strong that most economists agree that large deficits cause same reduction in the capital stock. However, the precise size of this reduction, and hence the reduction in welfare for future generations, is not known.

3. Ricardian Equivalence Theorem

Harvey S. Rosen, in his book *Public Finance,* wrote that Barro [1974] has argued that " when the government borrows, members of old generation realize that their heirs will be made worse off ". Suppose further that, the old care about the welfare of their descendants and therefore do not want their descendants' consumption levels reduced. What can the olds do about this? One possibility is simply to increase their bequests by an amount sufficient to pay the extra taxes that will be due in the future. The result is that nothing really changes. Each generation has exactly the same amount of consumption that it had before the government borrowed.

In effect, then, private individuals can undo the intergenerational effects of government debt policy so that tax and debt finance is essentially equivalent. This view that the form of government finance is irrelevant, is often referred to as Ricardian Model because, its antecedents appeared in the work of the 19th century British economist David Ricardo.

According to Harvey S. Rosen, author of the book *Public Finance*, Barro 's provocative hypothesis on the irrelevance of government fiscal policy has been the subject of many debates. Some reject the idea as being based on an

incredible assumption. Information on the implications of current deficits on future tax burdens is not easy to obtain; indeed, it isn't even clear how big the debt is! Harvey S. Rosen, in his book *Public Finance*, mentions about another criticism by Bernheim and Bagwell [1988] which argues that, " through marriage, virtually all people end up related to one another ". The model implies that the nation acts as one big happy family, busily undoing all government policy.

On the other hand, it could be argued that the ultimate test of the theory is not the plausibility of its assumptions, but whether or not it leads to the predictions that are confirmed by the data. Harvey S. Rosen in his book *Public Finance* states that, Gramlich [1989] noted that in early 1980's, there was a huge increase in federal deficits. If the Ricardian model were correct, one would have expected private savings to increase commensurately. At the same time the federal deficit increased, however, private savings (relative to net national product) actually fell. While this finding is suggestive, it is not conclusive because factors other than the deficit affect the saving rate. Harvey S. Rosen, author of the book *Public Finance,* mentions that Bernheim [1990] carried out a number of econometric studies and analysed the relationship between budget deficits and saving. Although the evidence is mixed, the general finding is that even after taking other variables into account, saving does not increase enough to offset increased deficits. There seems to be mounting evidence that although some intergenerational altruism doubtless exists, its presence does not render debt policy irrelevant.[5]

As it is mentioned while explaining the neo-classical view, in neo-classical model an increase in the debt would increase individuals ' wealth. Then the question "Are government bonds wealth?" is raised. According to Barro-Ricardo equivalence proposition that states that the debt financing by bond issue merely postpones taxation and in many instances it is strictly

[5] Ibid., p. 469.

equivalent to current taxation, bonds are not net wealth.[6] People realize that their bonds will have to be paid off with future increases in the budget deficit unaccompanied by savings that precisely match the deficit.

There are two main theoretical objections to the Barro-Ricardo approaches. First, given that people have finite lifetimes, the people who are receiving the tax cut today, will not be paying off the debt tomorrow. This argument assumes that people now alive do not take into account the higher taxes their descendants will have to pay in the future. Second, it is argued that many people cannot borrow, and thus do not consume according to their permanent income. They would like to consume more today but because of the liquidity constraints -their inability to borrow- they are constrained to consuming less than they would want according to their permanent income. A tax cut for these people eases their liquidity constraint and allows them to consume more.

These theoretical disagreements mean that the Barro - Ricardo hypothesis has to be settled by examining the empirical evidence. The evidence to date is on balance unfavourable to the Barro - Ricardo approach but recognises that the issue has not yet been decisively settled.

4. Keynesian Approach

Traditional Keynesian approach is separated from the neo-classical approach in two fundamental points. First one is the assumption that some economic resources are not fully employed in an economy. And the second one is the assumption that the individuals are short sighted in their decisions concerning the future. This second assumption leads to the result that aggregate demand is very sensitive to the changes in disposable income. According to this, in simple Keynesian model, since individuals will tend to consume their disposable income, a cut in personal taxes will create a sudden and important effect on aggregate demand and aggregate demand

[6] Dornbush and Fischer, op.cit., p.588.

will tend to increase. Unless there is full employment, national income will increase by the effect of known Keynesian multiplier (Figure-1.1). Thus there will not be any negative effect on saving and capital accumulation since budget deficits encouraged consumption and national income. Moreover, if households treat the debt with which the deficit is financed as a net worth, there may be further demand for expansion as a result of debt financing. This line of thinking has been sharply attacked and rejected by the neo-classical approach to fiscal policy.[7] The effects of fiscal policy in Keynesian model, can be seen in Figure-1.1 by analysing the IS and LM curves, assuming that there has been an increase in government spending.

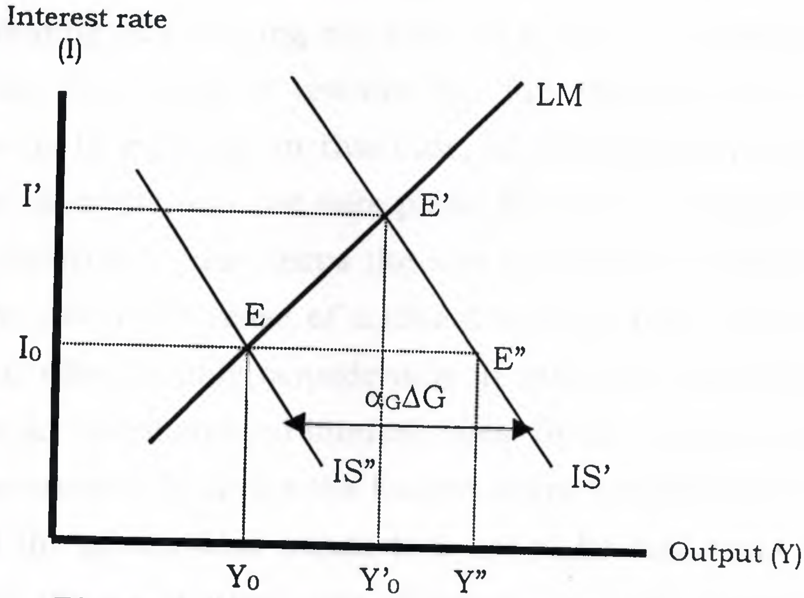


Figure-1.1 Increase in Government Spending

In the standard IS-LM analysis, this increase in national income will increase the demand for money.[8] If the money supply is fixed- meaning that borrowing from individuals and firms finances budget deficit - interest rates will increase and private investments will decrease by the crowding out effect. This means a decline in national income and balancing of the Keynesian multiplier effect due to the crowding out effect.

---

[7] Ibid., p. 587.
[8] Prof.Dr. Şevki ÖZBİLEN, **MALİYE POLİTİKASI**, Ezgi Kitabevi, 1998 Bursa, p.274

Many Keynesian economists support the view that no crowding out effect will be created on private investments due to budget deficits.[9] Because, the aggregate demand that is increased due to budget deficits will increase the profitability of the private investments and will lead to a higher investment level at a specific interest rate. In this case, in spite of the fact that budget deficit cause increases in the interest rates, it can encourage aggregate saving and investments. In other words, if there is not full employment in an economy, important budget deficits will influence the consumption due to the increased demand, as long as a negative monetary policy is not implemented. And as a result of increased profitability of investments due to the increased consumption, there will be a positive effect on investments creating no crowding out effect in spite of the increase in interest rates. But after the economy reaches the full employment level, general price level tends to increase. In this case, an increase in consumption or a decline in investments may not take place. Because, as long as the inflation tax at full employment case keeps the rate of increase of budget deficits equated with the rate of increase of national income, only inflation increases. Crowding out effect is only considerable in the case where there is a tight monetary policy and increased interest rates. But it is important that in the case where government finances the budget deficits by domestic borrowing, interest rate of the government bonds that are to be sold must be more attractive than the market interest rate. Since in this case interest rates will have to be increased, crowding out effect will be generated. As a result, the negative effect of budget deficits on the capital stock is only possible at the full employment level.[10]

[9] Ibid., p. 274.
[10] Dornbush and Fischer, op.cit., p.13.

II. FISCAL POLICY AND THE GENERAL BALANCE OF PUBLIC SECTOR IN THE TRNC

1. Introduction

Fiscal policy is a branch of general economic policy. When the tools used for achieving the economic policies are related to public economics, the intervention done is defined as the fiscal policy. Importance of public finance is increasing in the TRNC, due to the social and economic developments.

For achieving the macro economic targets, the state of TRNC has to implement its tax and public expenditure programs in harmony with the fiscal policy.

General Balance of public sector shows what proportion of the goods and services created is used by the public sector, how much of this proportion is consumed, how much is transferred to investments, what amount is saved and what is the need for finance if there are any. With these properties, general balance of public sector determines the revenues-expenditures balance and the need for additional finance.

In this chapter, the fiscal policy targets in the TRNC and the fiscal policy tools that are used to achieve the targets will be analysed. The elements of general balance of public sector will be listed and the period of 1982-1997 will be examined. By this way the evolution of public revenues and public expenditures will be displayed and public deficits together with the investments and savings of the public sector will be evaluated within the specified period. At the end of the chapter the result will be commented on together with the conclusions.

It will be noticed that, the period under consideration for the general balance of public sector (will be examined in this chapter) begins at the year 1982, while the period under consideration for the balance of state budget (will be

examined in the next chapter) begins at the year 1977. The reason for this is; data for the general balance of public sector was not collected by the State Planning Organization until the year 1982 and the data for the balance of state budget is used for this purpose until that time. Thus, the only available data that can be used for the analysis of general balance of public sector is the data of the period 1982-1997 (Tables 2.1, 2.2).

2. Fiscal Policy and Fiscal Policy Tools in the TRNC

The state, within the fiscal policy, uses three important tools for achieving stabilization and economic development, for maintaining and providing the economic equilibrium, for increasing the life standard and for establishing a more regular distribution of income and wealth. These tools are public expenditures, taxes and borrowings.[11] Three of these are the fiscal policy tools used in the TRNC.

In the TRNC, fiscal policy tools are employed in order to increase the savings and transfer them to productive fields of investments and attract foreign investors to the country.[12]

Fiscal policies in the TRNC are intended to be carried out in the direction of reducing the public current expenditures, increasing the infrastructure investments, and encouraging the private sector investments by use of selective tools. It is intended to attach more importance to tax exemption policies for investment tools and production inputs and to remove completely, the tax burden from the shoulders of production and investment.[13]

[11] Orhaner EMİNE, **KAMU MALİYESİ**, Gazi Kitabevi, 1997 Ankara, p.257.

[12] KKTC Başbakanlık, DPÖ, **ÜÇÜNCÜ BEŞ YILLIK KALKINMA PLANI 1993-1997 STRATEJİSİ, AMAÇLARI, MAKRO HEDEF VE DENGELERİ**, 1992 Lefkoşa, p.21.

[13] KKTC Başbakanlık, DPÖ, **1999 GEÇİŞ YILI PROGRAMI**, 1999 Lefkoşa, p.74.

BUDGET DEFICIT PROBLEM AND ITS IMPACT ON THE TRNC ECONOMY

ENGİN ARI

EASTERN MEDITERRANEAN UNIVERSITY
1999

EASTERN MEDITERRANEAN UNIVERSITY

INSTITUTE OF RESEARCH AND GRADUATE STUDIES

BUDGET DEFICIT PROBLEM AND ITS IMPACT ON THE TRNC ECONOMY

A MASTER'S THESIS
BY
ENGİN ARI
FOR THE DEGREE OF MASTER OF SCIENCE
IN
ECONOMICS

GAZIMAĞUSA September, 1999

BUDGET DEFICIT PROBLEM
AND ITS IMPACT
ON THE
TRNC
ECONOMY

by

Engin ARI
September, 1999

Dissertation submitted to Eastern Mediterranean University in partial fulfillment of the requirements for the degree of Master of Science in Economics

EASTERN MEDITERRANEAN UNIVERSITY
FACULTY OF BUSINESS AND ECONOMICS

Thesis Title : Budget Deficit Problem and Its Impact on the TRNC Economy.

Submitted by : Engin ARI

Department : Economics

Approval of the Institute of Research and Graduate Studies.

Assoc. Prof. Dr. Zeka MAZHAR
(Head of the Institute)

I certify that this thesis satisfies all the requirements as a thesis for the degree of Master of Science.

A. Yörükoğlu

Prof. Dr. Ahmet YÖRÜKOĞLU
(Head of Economics Department)

Thesis Examining Committee

A. Yörükoğlu

Prof. Dr. Ahmet YÖRÜKOĞLU
(Supervisor)

Assist. Prof. Dr. Danbala DANJU

Assist. Prof. Dr. Abdul GHAFOOR

Acknowledgements

I would like to express my deep gratitude to Prof. Dr. Ahmet Yörükoğlu for his self-sacrificing supervision and encouragement throughout this study. I also would like to thank Dr. Hasan A. Bıçak for his support. I am grateful to Mr. Ahmet Z. Bulunç for his continuous motivation as well as for his intellectual help. My sincere thanks are due to Mr. Birol Betoncu, Mr. Cevdet Başaran, Ms. Fatma Kınış and Ms. Hayriye Sonuvar. Their help in editing the final draft added a lot to the comprehensive value of the thesis. My special thanks are also to my wife Refia Arı and to my sons Anıl and Orhan for their patience and understanding in helping me to accomplish this work. Without their help, this work could not have been done.

Abstract

The Turkish Republic of Northern Cyprus is experiencing socio-economic structural problems that have been accumulated throughout the years since its establishment. The structural problems have led to the budget deficits that create a big burden on an economy. For, a budget is not only a legal document which specifies the public expenditures, revenues and public needs, but it is also an important instrument in the realisation of planned growth and socio-economic structure in a country.

The aim of this study is to investigate the effects of budget deficits on the economy of Turkish Republic of Northern Cyprus. Factors creating the budget deficits and the methods used in financing these deficits in Turkish Republic of Northern Cyprus have been discussed in detail.

In this study, public finance of Turkish Republic of Northern Cyprus in general and the budget deficit in particular, have been evaluated. The structures of the budget and the public sector have been analysed in a time perspective and the main problems concerning public finance of the country are identified.

The effects of financing the budget deficits on the economy and the methods used in financing the deficits have been investigated from different aspects, using various methods. Theoretical concepts about financing the budget deficits and about the effects that they create on an economy have been introduced and compared with the case in Turkish Republic of Northern Cyprus.

Within the frame of this study, some policy solutions for minimizing the negative effects of budget deficits on the economy have been suggested in brief.

Abstract

Kuzey Kıbrıs Türk Cumhuriyeti kuruluşundan bu yana yıllarca biriken yapısal sosyo-ekonomik sorunlar yaşamaktadır. Bu yapısal sorunlar, ekonomi üzerinde büyük bir yük oluşturan bütçe açıklarına neden olmuşlardır. Çünkü bütçe, yalnızca kamu gelir ve giderleri ile kamusal ihtiyaçları belirleyen bir yasal doküman değil, aynı zamanda, bir ülkede planlı büyüme ve sosyo-ekonomik yapının gerçekleştirilmesinde de önemli bir araçtır.

Bu çalışmanın amacı, Kuzey Kıbrıs Türk Cumhuriyeti ekonomisi üzerinde bütçe açıklarının etkilerini araştırmaktır. Kuzey Kıbrıs Türk Cumhuriyeti'nde bütçe açıklarını yaratan nedenler ve bu açıkların finansmanında kullanılan yöntemler detaylı olarak tartışılmıştır.

Bu çalışmada, genel olarak Kuzey Kıbrıs Türk Cumhuriyeti'nin kamu maliyesi ve detaylı olarak da bütçesi değerlendirilmiştir. Bütçe ve kamu sektörünün yapıları analiz edilerek ülkenin kamu maliyesinde yaşanan sorunlar bir zaman perspektifi içerisinde tanımlanmıştır.

Bütçe açıklarının finansmanının ekonomi üzerindeki etkileri ve açıkların finansmanında kullanılan yöntemler farklı yönlerden ve değişik yöntemler kullanılarak araştırılmıştır. Bütçe açıklarının finansmanı ve ekonomi üzerinde yarattıkları etkilerle ilgili teorik kavramlara değinilmiş ve Kuzey Kıbrıs Türk Cumhuriyeti'ndeki durumla karşılaştırma yapılmıştır.

Bu çalışma çerçevesinde, bütçe açıklarının ekonomi üzerindeki olumsuz etkilerini asgari seviyeye indirmek için kısa olarak bazı politika önerileri yapılmıştır.

TABLE OF CONTENTS

LIST OF TABLES , FIGURES AND GRAPHS

Preface

In recent years there have been a lot of discussions about budget deficits. Many economists and other observers have viewed these deficits as harmful to countries' economic positions. These harmful effects include high real interest rate, low savings, and low rates of economic growth and crowding out of private sector from the investments. In this context the financing methods of budget deficits are very important aspect of economic activities as well.

The Turkish Republic of Northern Cyprus has also had a serious budget deficit problem since 1977. The structural problems, especially the high share of public sector in the economy and the consequent low level of productivity, have led to the budget deficits in the country Current expenditures, especially the personnel expenditures and transfer payments, are the main elements that create budget deficits. Losses of the Public Economic Enterprises are other problems that cause budget deficits.

The usual way of financing budget deficits is either to engage in domestic borrowing via issuance of bonds and bills or the use of money financing method. The use of short-term advances from the Central Bank is another way of domestic borrowing. Issuance of bonds and bills has not been applicable to the Turkish Republic of Northern Cyprus since the financial market is not well developed. The use of money financing method, in other words, creating new money (printing money) is not applicable either since the Turkish Lira is in circulation as legal tender. Therefore, she does not have too many alternatives for financing its deficits. Aids and borrowing from Turkey finance large portion of her budget deficits, which have never been paid back. Some domestic borrowing is done through the Central Bank as short-term advances lent to the Treasury Department of the state. The size of domestic Treasury borrowing has changed significantly since the establishment of the Central Bank.

The aim of this study is to investigate the effects of budget deficits, on the economy of the Turkish Republic of Northern Cyprus. Another aim of the study is to suggest brief policy solutions for minimizing the negative effects of budget deficits on the economy of the country.

In Chapter I, three schools of thought concerning the economic effects of budget deficits are discussed; Neo-classical, Ricardian and Keynesian. The basic structure and implications of each paradigm is summarized under financing the budget deficits by debt instead of tax financing.

In Chapter II, public sector deficit and the ways of financing this deficit is analysed in a time perspective for the period 1982-1997. Also, fiscal policy tools that are employed in the Turkish Republic of Northern Cyprus are examined in this chapter.

In Chapter III, the budget of the country has been analysed in a time perspective for the period 1977-1997. As a result of this analysis, the causes of budget deficits are identified and the financing methods adopted in the country are examined with reference to the period 1977-1997.

In Chapter IV, effects of budget deficits on the economy of the country are discussed in detail. Interest rates, balance of investments and savings, developments in fixed capital investments and the distribution of advances and rediscounts from the Central Bank's resources together with the sectoral distribution of advances, loans and bills discounted from the whole banking system are analysed in a time perspective.

In Chapter V, conclusion of the study is drawn and policy solutions for minimizing the negative effects of budget deficits on the economy of the Turkish Republic of Northern Cyprus are suggested in brief.

I. THEORETICAL APPROACHES

1. Introduction

Traditional public finance theory mainly covers taxes, public expenditures and public debt. Taxes being weightier; borrowing is the main alternative to taxes for financing the budget deficits. Too many discussions have been made about public debt and deficit financing for years. The three theoretical approaches about the subject are generally considered while discussing the economic effects of the budget deficits. These approaches are the Neo-classical approach, the Keynesian approach and the Ricardian approach.

2. Standard Neo-classical Model

The neo-classical approach to fiscal policy emphasises the microeconomic linkages among government spending, debt and tax policies and their effects on households and firms. It asserts that the scope for active fiscal policy is radically less than what the Keynesian approach suggests.[1]

The neo-classical approach focuses on households, permanent income and ability to spend. If an individual's taxes are cut now, and if the same person has to pay off the interest and principal on the debt floated to finance the tax cut, the person's permanent income does not changed. In this example, there is no reason, on permanent income grounds; to think that a tax cut will increase the person's spending.

At the aggregate level, suppose everyone believed that the national debt would eventually be paid off. At some point in the future, the government would have to run a surplus to pay off the debt. That means it would have to raise taxes in the future. Therefore, an increase in the debt would increase individuals' wealth and at the same time suggest to them that their taxes

[1] Dornbush and Fischer, **MACROECONOMICS**, 6. Ed, McGrawhill, Singapore, 1994. p.587

would be higher in the future. The net effect on aggregate demand might then be zero.[2]

The neo-classical model of the debt stresses that when the government initiates a project, whether financed by taxes or borrowing, resources are removed from the private sector.[3] One usually assumes that when tax finance is used, most of the resources removed come at the expense of consumption. On the other hand, when government borrows, it competes for funds with individuals and firms who want the money for their own investment projects. Hence it is generally assumed that debt has most of its effect on private investment. To the extent that these assumptions are correct, debt finance leaves future generations with a smaller capital stock, ceteris paribus. Its members therefore are less productive and have smaller real incomes than otherwise would have been the case.

The assumption that government borrowing reduces private investment plays a key role in the neo-classical analysis. It is sometimes referred to as the *crowding out* hypothesis- when the public sector draws on the pool of resources available for investment, private investment is crowded out. Crowding out is induced by changes in the interest rate. When the government increases its demand for credit the interest rate, which is just the price for credit, must go up. But if the interest rate goes up, private investment becomes expensive and less of it is undertaken.[4] Unfortunately, things are complicated by the fact that other variables can also probably affect interest rates. For example, during a recession, investment decreases and hence the interest rate falls. At the same time, slack business conditions lead to smaller tax-collections, which increase the deficit, Ceteris paribus.

---

[2] Ibid., p. 588.
[3] Harvey S. Rosen, **PUBLIC FINANCE**, 4. Ed, IRWIN, USA, 1995. p. 467.
[4] Ibid., p. 467.

Hence, the data may show an inverse relationship between the interest rate and deficits, although this says nothing one way or the other about crowding out. As usual, the problem is to sort out the independent effect of deficits on interest rates, and this kind of problem can be quite difficult. According to Harvey S. Rosen, author of *Public Finance*, when Miller and Roberds [1992] reviewed the econometric studies of this issue, they found conflicting results. Despite the murkiness of the econometric evidence, the theoretical case for at least same crowding out is so strong that most economists agree that large deficits cause same reduction in the capital stock. However, the precise size of this reduction, and hence the reduction in welfare for future generations, is not known.

3. Ricardian Equivalence Theorem

Harvey S. Rosen, in his book *Public Finance,* wrote that Barro [1974] has argued that " when the government borrows, members of old generation realize that their heirs will be made worse off ". Suppose further that, the old care about the welfare of their descendants and therefore do not want their descendants' consumption levels reduced. What can the olds do about this? One possibility is simply to increase their bequests by an amount sufficient to pay the extra taxes that will be due in the future. The result is that nothing really changes. Each generation has exactly the same amount of consumption that it had before the government borrowed.

In effect, then, private individuals can undo the intergenerational effects of government debt policy so that tax and debt finance is essentially equivalent. This view that the form of government finance is irrelevant, is often referred to as Ricardian Model because, its antecedents appeared in the work of the 19th century British economist David Ricardo.

According to Harvey S. Rosen, author of the book *Public Finance*, Barro 's provocative hypothesis on the irrelevance of government fiscal policy has been the subject of many debates. Some reject the idea as being based on an

incredible assumption. Information on the implications of current deficits on future tax burdens is not easy to obtain; indeed, it isn't even clear how big the debt is! Harvey S. Rosen, in his book *Public Finance*, mentions about another criticism by Bernheim and Bagwell [1988] which argues that, " through marriage, virtually all people end up related to one another ". The model implies that the nation acts as one big happy family, busily undoing all government policy.

On the other hand, it could be argued that the ultimate test of the theory is not the plausibility of its assumptions, but whether or not it leads to the predictions that are confirmed by the data. Harvey S. Rosen in his book *Public Finance* states that, Gramlich [1989] noted that in early 1980's, there was a huge increase in federal deficits. If the Ricardian model were correct, one would have expected private savings to increase commensurately. At the same time the federal deficit increased, however, private savings (relative to net national product) actually fell. While this finding is suggestive, it is not conclusive because factors other than the deficit affect the saving rate. Harvey S. Rosen, author of the book *Public Finance,* mentions that Bernheim [1990] carried out a number of econometric studies and analysed the relationship between budget deficits and saving. Although the evidence is mixed, the general finding is that even after taking other variables into account, saving does not increase enough to offset increased deficits. There seems to be mounting evidence that although some intergenerational altruism doubtless exists, its presence does not render debt policy irrelevant.[5]

As it is mentioned while explaining the neo-classical view, in neo-classical model an increase in the debt would increase individuals ' wealth. Then the question "Are government bonds wealth?" is raised. According to Barro-Ricardo equivalence proposition that states that the debt financing by bond issue merely postpones taxation and in many instances it is strictly

[5] Ibid., p. 469.

equivalent to current taxation, bonds are not net wealth.[6] People realize that their bonds will have to be paid off with future increases in the budget deficit unaccompanied by savings that precisely match the deficit.

There are two main theoretical objections to the Barro-Ricardo approaches. First, given that people have finite lifetimes, the people who are receiving the tax cut today, will not be paying off the debt tomorrow. This argument assumes that people now alive do not take into account the higher taxes their descendants will have to pay in the future. Second, it is argued that many people cannot borrow, and thus do not consume according to their permanent income. They would like to consume more today but because of the liquidity constraints -their inability to borrow- they are constrained to consuming less than they would want according to their permanent income. A tax cut for these people eases their liquidity constraint and allows them to consume more.

These theoretical disagreements mean that the Barro - Ricardo hypothesis has to be settled by examining the empirical evidence. The evidence to date is on balance unfavourable to the Barro - Ricardo approach but recognises that the issue has not yet been decisively settled.

4. Keynesian Approach

Traditional Keynesian approach is separated from the neo-classical approach in two fundamental points. First one is the assumption that some economic resources are not fully employed in an economy. And the second one is the assumption that the individuals are short sighted in their decisions concerning the future. This second assumption leads to the result that aggregate demand is very sensitive to the changes in disposable income. According to this, in simple Keynesian model, since individuals will tend to consume their disposable income, a cut in personal taxes will create a sudden and important effect on aggregate demand and aggregate demand

[6] Dornbush and Fischer, op.cit., p.588.

will tend to increase. Unless there is full employment, national income will increase by the effect of known Keynesian multiplier (Figure-1.1). Thus there will not be any negative effect on saving and capital accumulation since budget deficits encouraged consumption and national income. Moreover, if households treat the debt with which the deficit is financed as a net worth, there may be further demand for expansion as a result of debt financing. This line of thinking has been sharply attacked and rejected by the neo-classical approach to fiscal policy.[7] The effects of fiscal policy in Keynesian model, can be seen in Figure-1.1 by analysing the IS and LM curves, assuming that there has been an increase in government spending.

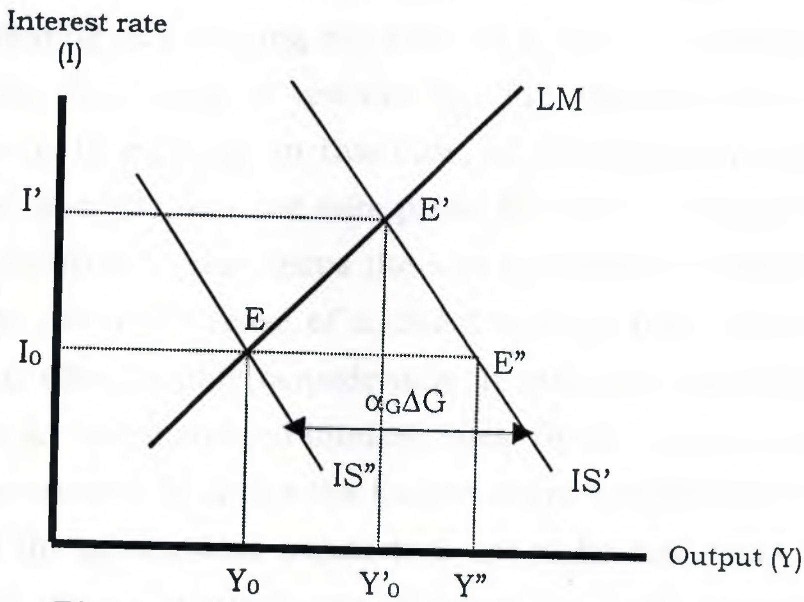


Figure-1.1 Increase in Government Spending

In the standard IS-LM analysis, this increase in national income will increase the demand for money.[8] If the money supply is fixed- meaning that borrowing from individuals and firms finances budget deficit - interest rates will increase and private investments will decrease by the crowding out effect. This means a decline in national income and balancing of the Keynesian multiplier effect due to the crowding out effect.

[7] Ibid., p. 587.
[8] Prof.Dr. Şevki ÖZBİLEN, **MALİYE POLİTİKASI**, Ezgi Kitabevi, 1998 Bursa, p.274

Many Keynesian economists support the view that no crowding out effect will be created on private investments due to budget deficits.[9] Because, the aggregate demand that is increased due to budget deficits will increase the profitability of the private investments and will lead to a higher investment level at a specific interest rate. In this case, in spite of the fact that budget deficit cause increases in the interest rates, it can encourage aggregate saving and investments. In other words, if there is not full employment in an economy, important budget deficits will influence the consumption due to the increased demand, as long as a negative monetary policy is not implemented. And as a result of increased profitability of investments due to the increased consumption, there will be a positive effect on investments creating no crowding out effect in spite of the increase in interest rates. But after the economy reaches the full employment level, general price level tends to increase. In this case, an increase in consumption or a decline in investments may not take place. Because, as long as the inflation tax at full employment case keeps the rate of increase of budget deficits equated with the rate of increase of national income, only inflation increases. Crowding out effect is only considerable in the case where there is a tight monetary policy and increased interest rates. But it is important that in the case where government finances the budget deficits by domestic borrowing, interest rate of the government bonds that are to be sold must be more attractive than the market interest rate. Since in this case interest rates will have to be increased, crowding out effect will be generated. As a result, the negative effect of budget deficits on the capital stock is only possible at the full employment level.[10]

[9] Ibid., p. 274.
[10] Dornbush and Fischer, op.cit., p.13.

II. FISCAL POLICY AND THE GENERAL BALANCE OF PUBLIC SECTOR IN THE TRNC

1. Introduction

Fiscal policy is a branch of general economic policy. When the tools used for achieving the economic policies are related to public economics, the intervention done is defined as the fiscal policy. Importance of public finance is increasing in the TRNC, due to the social and economic developments.

For achieving the macro economic targets, the state of TRNC has to implement its tax and public expenditure programs in harmony with the fiscal policy.

General Balance of public sector shows what proportion of the goods and services created is used by the public sector, how much of this proportion is consumed, how much is transferred to investments, what amount is saved and what is the need for finance if there are any. With these properties, general balance of public sector determines the revenues-expenditures balance and the need for additional finance.

In this chapter, the fiscal policy targets in the TRNC and the fiscal policy tools that are used to achieve the targets will be analysed. The elements of general balance of public sector will be listed and the period of 1982-1997 will be examined. By this way the evolution of public revenues and public expenditures will be displayed and public deficits together with the investments and savings of the public sector will be evaluated within the specified period. At the end of the chapter the result will be commented on together with the conclusions.

It will be noticed that, the period under consideration for the general balance of public sector (will be examined in this chapter) begins at the year 1982, while the period under consideration for the balance of state budget (will be

examined in the next chapter) begins at the year 1977. The reason for this is; data for the general balance of public sector was not collected by the State Planning Organization until the year 1982 and the data for the balance of state budget is used for this purpose until that time. Thus, the only available data that can be used for the analysis of general balance of public sector is the data of the period 1982-1997 (Tables 2.1, 2.2).

2. Fiscal Policy and Fiscal Policy Tools in the TRNC

The state, within the fiscal policy, uses three important tools for achieving stabilization and economic development, for maintaining and providing the economic equilibrium, for increasing the life standard and for establishing a more regular distribution of income and wealth. These tools are public expenditures, taxes and borrowings.[11] Three of these are the fiscal policy tools used in the TRNC.

In the TRNC, fiscal policy tools are employed in order to increase the savings and transfer them to productive fields of investments and attract foreign investors to the country.[12]

Fiscal policies in the TRNC are intended to be carried out in the direction of reducing the public current expenditures, increasing the infrastructure investments, and encouraging the private sector investments by use of selective tools. It is intended to attach more importance to tax exemption policies for investment tools and production inputs and to remove completely, the tax burden from the shoulders of production and investment.[13]

[11] Orhaner EMİNE, **KAMU MALİYESİ**, Gazi Kitabevi, 1997 Ankara, p.257.

[12] KKTC Başbakanlık, DPÖ, **ÜÇÜNCÜ BEŞ YILLIK KALKINMA PLANI 1993-1997 STRATEJİSİ, AMAÇLARI, MAKRO HEDEF VE DENGELERİ**, 1992 Lefkoşa, p.21.

[13] KKTC Başbakanlık, DPÖ, **1999 GEÇİŞ YILI PROGRAMI**, 1999 Lefkoşa, p.74.

3. General Balance of Public Sector

3.1 Public Revenues

In spite of the fact that private saving is voluntary, public revenues are considered to be inevitable sources in the creation of capital sources for the economy. Because of this, it is one of the priorities of the states to improve public revenues for the formation of the country's capital sources and for speedily increasing them.

In the TRNC, importance is attached to increase of public revenues for the improvement of capital sources and for the activation of the public services. Public revenues in the TRNC are composed of three main elements, which are:

i- Tax revenues
ii- Income other than Taxes
iii- Factor and Fund revenues.

Within the context of this study, Public Revenues are sometimes referred to as "Total Public Revenues" in order to imply that they are composed of the sum of the three elements mentioned above.

3.1.1 Tax Revenues

Tax revenues are made up of direct and indirect taxes.

i) Direct Taxes:

- Income tax
- Vehicle and driving licenses
- Institutions tax
- Property tax
- Inheritance tax.

ii) Indirect Taxes:

- Customs tax
- Bank and insurance tax
- Value Added Tax.[14]

3.1.2 Income Other Than Taxes

Public revenues include some revenues, which can not be classified as taxes. These are:

i- Revenues which can not be classified as Taxes:

a) Fees:

- Court fees
- Fees for company and partners registration;
- Property registration fees
- Import and export certificate fees
- Identity registration fees
- Passport fees
- Other fees

b) Revenues of Services Provided:

- Telephone-telegrams and telex charges
- Postal charges
- Theatre, sports and cultural activities charges
- Travelling fees
- Overtime pays of customs and port
- Warehouse rents
- Port and boats charges
- Fines and confiscation.

[14] Ekonomi ve Maliye Bakanlığı, KKTC 1995 **MALİ YILI BÜTÇE TASARISI**, 1994, pp.31-34.

ii- Revenues of Public Enterprises:

These are mainly the revenues from:

- Cypruvex Public Enterprises,
- State Breeding Farm;
- Institution of Electricity Supplies.

iii- Treasury Property Rents.

iv- Various revenues

- Revenues from state publications;
- Contributions of state personnel (by retirement law)
- Sales of telephone directory.

3.1.3 Factor and Fund Revenues

The law passed in 1992 and the statutes applied in 1993, have allowed the public to use funds as revenues, starting from 1994's budget. Hence 50 % of:

- Foreign exchange stability fund,
- Price stability fund, and
- 10% of Tourism encouragement fund

(To be transferred to state budget), are used as revenues.

3.1.3.1 Types of Fund Revenues Used

i-Foreign Exchange Stability Fund

These are the fund revenues of the state from differences in the rate of exchange. They are obtained from the exports of goods. The main aim of this fund is to be able to meet the negative effects in case of unexpected shocks in financial markets.

ii- Price Stability Fund

They are the charges imposed on products the use or import of which are sought to be discouraged such as cigarette, alcohol etc. Besides others, it also laid on petrol prices. According to some economists this fund is introduced for contributing to the construction and management of the electricity plant in Teknecik.

iii- Tourism Encouragement Fund

These funds are generated from the travellers at the customs. It is a kind of tax imposed on foreigners. The aim of this fund is to contribute to the promotion and infrastructure of tourism.

On one hand, it seems economically logical to have such funds, as they will be used for improving the infrastructure, for the protection of producers and for the promotion of tourism. But on the other hand, it is well known that these funds are not used for fulfilling the objectives they are implemented for, but are used for financing the public current expenditures and the deficits.

Public revenues have increased from 6,097.5 Million TL in 1982 to 41,249,297.0 Million TL in 1997 at current prices. At 1977 constant prices, public revenues increased from 780.2 Million TL in 1982 to 2,779.5 Million TL in 1997 (Tables-2.1, 2.2). The increase in public revenues in this period (1982-1997) has been 256.3% in total. The yearly average rise in this period has realized as 8.5%.[15] The share of public revenues in GNP has increased from 17.9% in 1982 to 34.9% in 1997. This result shows that there has been a total increase of 95.0% in the share of revenues in GNP within the period. This increase in share of public revenues in GNP amounts to a yearly average rise of 4.5%. The average share of the revenues in GDP for the period has been realized as 31.2% (Table-2.4).

[15] Yearly average rise is calculated by using the compound rate of growth formula $P_t = P_0 . e^{rt}$. For further detail see Damodar Gujarati, **ESSENTIALS OF ECONOMETRICS**, McGraw-Hill, 1992 U.S.A, p.232.

Table-2.1GENERAL BALANCE OF PUBLIC SECTOR

(Current Prices, Millon TL)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
I. Public Revenues	6,097.5	12,236.2	20,049.1	32,192.9	49,179.7	94,146.8	178,942.2	286,859.4	573,648.1	855,055.7	1,263,950.8	2,401,999.9	6,229,157.8	10,753,633.8	20,673,365.5	41,249,297.0
1. Taxes	3,489.1	6,723.1	10,578.7	17,580.0	26,329.5	48,246.9	90,713.0	162,989.3	331,717.8	430,621.2	737,868.2	1,408,500.4	3,160,404.8	6,300,178.6	11,647,287.6	25,743,868.1
a) Direct Taxes	1,515.0	2,895.1	5,004.5	8,592.0	14,496.3	26,227.4	47,205.7	84,424.3	166,109.9	248,397.8	401,781.5	743,923.0	1,813,865.8	3,672,222.2	6,595,689.4	14,334,207.8
b) Indirect Taxes	1,974.1	3,828.0	5,574.2	8,988.0	11,833.2	22,019.5	43,507.3	78,565.0	165,607.9	182,223.4	336,086.7	664,577.4	1,346,539.0	2,627,956.4	5,051,598.2	11,409,660.3
2. Income Other Than Taxes	1,070.0	1,915.7	2,580.4	3,916.0	6,951.5	10,764.0	18,470.3	32,759.4	58,611.3	107,806.5	175,422.2	338,361.2	855,053.7	1,982,078.5	3,630,912.5	7,513,055.1
3. Income From Factors and Funds	1,538.4	3,597.4	6,890.0	10,696.9	15,898.7	35,135.9	69,758.9	91,110.7	183,319.0	316,628.0	350,660.4	655,138.3	2,213,699.3	2,471,376.7	5,395,165.4	7,992,373.8
II. Transfers	2,899.0	4,801.1	7,935.7	15,534.8	25,529.7	37,962.5	51,551.6	77,122.9	167,717.1	303,023.7	468,764.1	874,006.4	2,282,638.7	5,787,485.4	9,815,806.1	19,318,478.3
III. Public Disposable Expenditures	3,198.5	7,435.1	12,113.4	16,658.1	23,650.0	56,184.3	127,390.6	209,736.5	405,931.0	552,032.0	795,186.7	1,527,993.5	3,946,519.1	4,966,148.4	10,857,559.4	21,930,818.7
IV. Public Current Expenditures	7,722.0	9,451.3	16,157.9	26,372.4	41,136.1	59,710.8	95,975.7	169,992.7	350,359.4	591,644.5	909,361.0	1,523,275.7	3,944,913.8	8,078,733.9	14,228,783.4	29,112,466.5
V. Public Savings	-4,523.5	-2,016.2	-4,044.5	-9,714.3	-17,486.1	-3,526.5	31,414.9	39,743.8	55,571.6	-39,612.5	-114,174.3	4,717.8	1,605.3	-3,112,585.5	-3,371,224.0	-7,181,647.8
VI. Public Investments	1,679.8	3,766.8	6,065.7	8,365.4	12,583.5	23,032.1	21,653.1	42,734.5	102,328.4	93,532.3	213,758.2	452,475.2	813,533.6	1,275,418.4	4,160,245.5	7,410,813.1
1. Fixed Capital	1,745.8	3,203.7	5,095.6	7,626.4	10,913.9	21,707.2	17,462.8	38,015.4	91,938.0	84,132.2	157,994.1	407,014.0	780,605.1	1,152,616.9	3,786,884.0	6,555,971.6
2. Changes in Stocks	-66.0	563.1	970.1	739.0	1,669.6	1,324.9	4,190.3	4,719.1	10,390.4	9,400.1	55,764.1	45,461.2	32,928.5	122,801.5	373,361.5	854,841.5
VII. Public Deficit	6,203.3	5,783.0	10,110.2	18,079.7	30,069.6	26,558.6	-9,761.8	2,990.7	46,756.8	133,144.8	327,932.5	447,757.4	811,928.3	4,388,003.9	7,531,469.5	14,592,460.9

Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-14, 1998 Lefkoşa, pp.22,23.

Table-2.2 GENERAL BALANCE OF PUBLIC SECTOR

(1977 Prices, Million TL)

		1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
I.	Public Revenues	780.2	1,155.0	1,281.3	1,289.1	1,342.0	1,851.0	2,240.8	2,081.3	2,586.0	2,484.4	2,230.3	2,611.8	2,730.5	2,279.7	2,495.2	2,779.5
	1. Taxes	446.5	634.6	676.1	704.0	718.3	948.6	1,135.9	1,182.6	1,495.4	1,251.2	1,302.0	1,531.5	1,385.3	1,335.6	1,405.8	1,734.6
	a) Direct Taxes	193.9	273.3	319.9	344.1	395.5	515.7	591.1	612.6	748.8	721.7	709.0	808.9	795.1	778.5	796.1	965.8
	b) Indirect Taxes	252.6	361.3	356.2	359.9	322.8	432.9	544.8	570.0	746.6	529.5	593.0	722.6	590.2	557.1	609.7	768.8
	2. Income Other Than Taxes	136.9	180.8	164.9	156.8	189.7	211.6	231.3	237.7	264.2	313.2	309.5	367.9	374.8	420.2	438.2	506.3
	3. Income From Factors and Funds	196.8	339.6	440.3	428.3	434.0	690.8	873.6	661.0	826.4	920.0	618.8	712.4	970.4	523.9	651.2	538.5
II.	Transfers	370.9	453.1	507.2	622.1	696.7	746.4	645.6	559.6	756.7	880.4	827.2	950.4	1,000.6	1,226.9	1,184.7	1,301.7
III.	Public Disposable Expenditures	409.3	701.9	774.1	667.0	645.3	1,104.6	1,595.2	1,521.7	1,829.9	1,604.0	1,403.1	1,661.4	1,729.9	1,052.8	1,310.5	1,477.7
IV.	Public Current Expenditures	988.1	892.2	1,032.6	1,056.0	1,122.3	1,174.0	1,201.8	1,233.4	1,579.4	1,719.1	1,604.6	1,656.3	1,729.2	1,712.7	1,717.2	1,961.6
V.	Public Savings	-578.8	-190.3	-258.5	-389.0	-477.0	-69.4	393.4	288.3	250.5	-115.1	-201.5	5.1	0.7	-659.9	-406.7	-483.9
VI.	Public Investments	215.0	355.5	387.6	335.0	343.4	452.8	271.2	310.0	461.3	271.8	377.2	492.0	356.6	270.3	502.2	499.3
	1. Fixed Capital	223.4	302.4	325.6	305.4	297.8	426.8	218.7	275.8	414.5	244.5	278.8	442.6	342.2	244.3	457.1	441.7
	2. Changes in Stocks	-8.4	53.1	62.0	29.6	45.6	26.0	52.5	34.2	46.8	27.3	98.4	49.4	14.4	26.0	45.1	57.6
VII.	Public Deficit	793.8	545.8	646.1	724.0	820.4	522.2	-122.2	21.7	210.8	386.9	578.7	486.9	355.9	930.2	908.9	983.2

Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler,Table-15, 1998 Lefkoşa, p.24.

Table-2.3 Public Revenues					(At 1977 prices, Million TL)		
Years	**Taxes**	**%**	**Income Other Than Taxes**	**%**	**Factor and Fund Revenues**	**%**	**Total Public Revenues**
1982	446.5	57.2	136.9	17.6	196.8	25.2	780.2
1983	634.6	54.9	180.8	15.7	339.6	29.4	1,155.0
1984	676.1	52.8	164.9	12.9	440.3	34.4	1,281.3
1985	740.0	57.4	156.8	12.2	428.3	33.2	1,289.1
1986	718.3	53.5	189.7	14.1	434.0	32.3	1,342.0
1987	948.6	51.3	211.6	11.4	690.8	37.3	1,851.0
1988	1,135.9	50.7	231.3	10.3	873.6	39.0	2,240.8
1989	1,182.6	56.8	237.7	11.4	661.0	31.8	2,081.3
1990	1,495.4	57.8	264.2	10.2	826.4	32.0	2,586.0
1991	1,251.2	50.4	313.2	12.6	920.0	37.0	2,484.4
1992	1,302.0	58.4	309.5	13.9	618.8	27.8	2,230.3
1993	1,531.5	58.6	367.9	14.1	712.4	27.3	2,611.8
1994	1,385.3	50.7	374.8	13.7	970.4	35.5	2,730.5
1995	1,335.6	58.6	420.2	18.4	523.9	23.0	2,279.7
1996	1,405.8	56.3	438.2	17.6	651.2	26.1	2,495.2
1997	1,734.6	62.4	506.3	18.2	538.5	19.4	2,779.5

--Shares are calculated by using the statistics of the SPO

--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, 1998 Lefkoşa, Table-15, p.24.

Tax revenues have increased from 446.5 Million TL in 1982 to 1,734.6 Million TL in 1997 at 1977 constant prices. This result amounts to a rise of 288.5% in total and 9.1% yearly average for the period (Table-2.2). The average share of tax revenues in total public revenues has been 55.6% in the period 1982-1997 (Table-2.2). The ratio of tax revenues to GNP increased from 10.2% in 1982 to 21.8% in 1997. This result shows a total increase of 113.7% in the ratio of tax revenues to GNP within the period. The average yearly rise of this ratio has been 5.2%. The average ratio of tax revenues to GNP for the period has been 17.3% (Table-2.4).

Income other than taxes has increased from 136.9 Million TL in 1982, to 506.3 Million TL in 1997 at 1977 constant prices. This result shows an increase of 269.8% in total and a 8.7% average yearly rise within the period (Table-2.2). The period's average share of income other than taxes in total public revenues has been 14.0% (Table-2.3). The ratio of income other than taxes to GNP has increased from 3.1% in 1982 to 6.4% in 1997. This result has shown a total of 106.5% increase in this ratio within the period. The average yearly increase in the ratio of income other than taxes to GNP has been 5.2%. Period's average for this ratio has been realized as 4.3% (Table-2.4).

Factor and fund revenues have increased from 196.8 Million TL in 1982 to 538.5 Million TL in 1997 at 1977 constant prices. This result shows an increase of 173.6% in total and a rise of yearly average 6.7% in real terms within the period (Table-2.2). The period's average share of factor and fund revenues in total public revenues has been 30.7% (Table-2.3). The ratio of factor and fund revenues to GNP has increased from 4.5% in 1982 to 6.8% in1997. This result amounts to a total increase of 51.1% in the ratio of factor and fund revenues to GNP, and a yearly average rise of 2.8% in this ratio, for the period. The average ratio of factor and fund revenues to GNP has been 9.6% for the period [Table-2.4).

The decline in the share of factor and fund revenues in total public revenues in 1997 is noticeable (Table-2.3). This is mainly due to the continuous high losses of Cypruvex Public Enterprises Company.[16] The increase in tax revenues due to the VAT and Property tax applications has also played a role in the decline in the share of factor and fund revenues.[17] On the other hand, the highest increase in the share of total public revenues within the period 1982-1991 has been realized in factor and fund revenues with an increase of 13.8% in 1988 (Table-2.3). This was because of the increase in social security funds.[18]

It is obvious that the highest share in public revenues is the share of tax revenues within the period 1982-1997, reaching the highest share with 62.41% in 1997. This shows that taxes form the main source of public revenues. Therefore, in the TRNC, state uses the taxes as the main fiscal policy tool for increasing its revenues.

Composition of Public Revenues can be seen in Graph-2.1a.

---

[16] KKTC Başbakanlık, **DPÖ, 1998 GEÇİŞ YILI PROGRAMI**, Lefkoşa 1997, p.39.
[17] Ibid., p.39.
[18] İktisadi Araştırmalar Vakfı, **KKTC EKONOMİSİNİN YENİDEN YAPILANMASI**, İstanbul 1993, p.47.

Table-2.4 Public Revenues – Ratios to GNP - (At 1977 prices, Million TL)

Years	GNP	Taxes	% GNP	Income Other Than Taxes	% GNP	Factor and Fund Revenues	% GNP	Total Public Revenues	% GNP
1982	4,369.5	446.5	10.2	136.9	3.1	196.8	4.5	780.2	17.9
1983	4,440.4	634.6	14.3	180.8	4.1	339.6	7.7	1,155.0	26.0
1984	4,725.2	676.1	14.3	164.9	3.5	440.3	9.3	1,281.3	27.1
1985	5,080.4	740.0	14.6	156.8	3.1	428.3	8.4	1,289.1	25.4
1986	5,324.1	718.3	13.5	189.7	3.6	434.0	8.2	1,342.0	25.2
1987	5,684.1	948.6	16.7	211.6	3.7	690.8	12.2	1,851.0	32.6
1988	6,084.0	1,135.9	18.7	231.3	3.8	873.6	14.4	2,240.8	36.8
1989	6,603.0	1,182.6	17.9	237.7	3.6	661.0	10.0	2,081.3	31.5
1990	6,977.4	1,495.4	21.4	264.2	3.8	826.4	11.8	2,586.0	37.1
1991	6,606.4	1,251.2	18.9	313.2	4.7	920.0	13.9	2,484.4	37.6
1992	7,124.7	1,302.0	18.3	309.5	4.3	618.8	8.7	2,230.3	31.3
1993	7,547.4	1,531.5	20.3	367.9	4.9	712.4	9.4	2,611.8	34.6
1994	7,268.3	1,385.3	19.1	374.8	5.2	970.4	13.4	2,730.5	37.6
1995	7,457.8	1,335.6	17.9	420.2	5.6	523.9	7.0	2,279.7	30.6
1996	7,673.4	1,405.8	18.3	438.2	5.7	651.2	8.5	2,495.2	32.5
1997	7,966.2	1,734.6	21.8	506.3	6.4	538.5	6.8	2,779.5	34.9
Results For the Period									
Total Change (%)		288.5	113.7	269.8	106.5	173.6	51.1	256.3	95.0
Yearly Average (%)		10.0	5.5	10.0	5.2	7.0	2.9	9.0	4.8
Period's Average (%)			17.3		4.3		9.6		31.2

--Shares are calculated by using the statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, 1998 Lefkoşa, Tables-1,15, pp 1, 24.

3.2 Public Expenditures

Public expenditures are the monetary expenditures done by the public authorities within certain rules, in order to meet the pubic needs and/or, in order to intervene in the economic and social life.[19]

Public expenditures in the TRNC are composed of three main elements, which are:

i- Current Expenditures

ii- Public Investments

iii- Transfer Payments.

[19] İsmail Türk, **KAMU MALİYESİ**, Turhan Kitabevi, 1996 Ankara, p.25.

It will be noticed in the next chapter that when the budget expenditures of the state budget balance is considered, another component which is the *Defence Expenditures,* comes into the question in addition to the three components above. The reason that the defence expenditures are not shown as a separate component in this chapter is, because they are included in the current expenditures when general balance of public sector is under consideration.

On the other hand, the difference between the general balance of public sector and the state budget balance (balance of state revenues and expenditures) is due to the coverage of their components. That is, current expenditures, investments and transfer payments cover the related expenses of the public institutions or units such as the Central Bank and Development Bank when the balance of public sector is under consideration, where as these expenses are not included in the state budget balance. State budget balance only considers the expenditures and revenues of the state organization such as ministries. This is the reason for the differences in figures of similar items between the Tables 2.1, 2.2 and 3.1, 3.2.

Within the context of this study, Public Expenditures are sometimes referred to as "Total Public Expenditures" in order to imply that they are composed of the sum of the three elements mentioned above.

3.2.1 Current Expenditures

It is the current expenditures that cover the highest share of the public expenditures. They are the expenditures made on personnel wages and salaries and also the other current expenditures:

- Victuals
- Post, telephone, cleaning expenses
- Consumed goods and purchased supplies
- Fixtures and other payments.[20]

[20] Ekonomi ve Maliye Bakanlığı, op.cit., p.65.

3.2.2 Public Investments

Public investments consist of the money spend on:

- Infrastructure for transportation and communication;
- Buildings for constructions and extensive restorations;
- Constructions and caring of water walls;
- Agriculture and forestry;
- Vehicles and machinery;
- Infrastructure for tourism and industry;
- Social services.[21]

3.2.3 Transfer Payments

The second biggest share of expenditures is realized by transfer payments. The transfers are made up of:

i- Social Transfers:

Pensions given to the pensioners, fees to social security fund, aid to the poor, scholarships, aid to martyr families and war veterans are the payments made under the heading of social transfers.

ii- Other Transfers:

They are financial and economic transfers:

Financial transfers:

- Aid to sports federation
- Aid to Turk Agency Kıbrıs (State News Agency)
- Aid to political parties;
- Contribution to BRTK;
- Contribution to religious institutions.

Economic transfers:

- Contributions to institution of agriculture (TÜK);
- Transfers to municipalities and other local institutions
- Transfers to public enterprises for capital accumulation.[22]

---

[21] Ibid., p.19.
[22] Ibid., pp.20-21.

Public expenditures have increased from 12,300.8 Million TL in 1982 to 55,841,758.6 Million TL in 1997 at current prices. At 1977 constant prices, the public expenditures have increased from 1,574.0 Million TL in 1982 to 3,762.6 Million TL in 1997. This increase shows a total increase of 139.1% and yearly average rise of 5.8% within the period. The ratio of public expenditures to GNP has increased from 36.0% in 1982 to 47.0% in 1997. This result shows a total increase of 30.6% and yearly average rise of 1.8% in this ratio within the period (Table-2.5). The average ratio of public expenditures to GNP has been 40.3% for the period (Table-2.6).

Table-2.5 Public Expenditures (At 1977 prices, Million TL)

Years	Current Expend.	%	Investments	%	Transfers	%	Total Public Expenditures
1982	988.1	62.8	215.0	13.7	370.9	23.6	1,574.0
1983	892.2	52.5	355.5	20.9	453.1	26.6	1,700.8
1984	1,032.6	53.7	387.6	20.2	507.2	26.4	1,921.4
1985	1,056.0	52.5	335.0	16.6	622.1	30.9	2,013.1
1986	1,122.3	51.9	343.4	15.9	696.7	32.2	2,162.4
1987	1,174.0	49.5	452.8	19.1	746.4	31.5	2,373.2
1988	1,201.8	56.7	271.2	12.8	645.6	30.5	2,118.6
1989	1,233.4	58.6	310.0	14.7	559.6	26.6	2,103.0
1990	1,579.4	56.5	461.3	16.5	756.1	27.0	2,796.8
1991	1,719.1	59.9	271.8	9.5	880.4	30.7	2,871.3
1992	1,604.6	57.1	377.2	13.4	827.2	29.4	2,809.0
1993	1,656.3	53.5	492.0	15.9	950.4	30.7	3,098.7
1994	1,729.2	56.0	356.6	11.6	1,000.6	32.4	3,086.4
1995	1,712.7	52.7	270.3	8.3	1,266.9	39.0	3,249.9
1996	1,717.2	50.4	502.2	14.8	1,184.7	34.8	3,404.1
1997	1,961.6	52.1	499.3	13.3	1,301.7	34.6	3,762.6

--Shares are calculated by using the statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, 1998 Lefkoşa, Table-15, p.24.

Current expenditures have increased from 988.1 Million TL in 1982 to 1,961.6 Million TL in 1997 at 1977 constant prices within the period. This result shows a total increase of 98.5% and a yearly average rise of 4.6% during the period 1982-1997. The average share of current expenditures in total public expenditures has been 54.8% (Table-2.5). The ratio of current expenditures to GNP has increased steadily from 22.6% in 1982 to 24.6% in 1997. This result shows a total of 8.9% increase and a yearly average rise of 0.6% during the period. The average ratio of current expenditures to GNP has been 22.0% for the period (Table-2.5).

Public investments have increased from 215.0 Million TL in 1982 to 499.3 Million TL in 1997, at 1977 constant prices within the period. This result shows a total increase of 132.2% and a yearly average rise of 6.0% for the period. The average share of public investments in total public expenditures have been 14.8% (Table-2.5) for the period. The ratio of public investments to GNP has increased from 4.9% in 1982 to 6.3% in 1997. This result shows a total increase of 28.5% and yearly average of 1.8% in the ratio of investments to GNP within the period. The average ratio of investments to GNP has been 5.9% for the period (Table-2.6)

Table-2.6 Public Expenditures – Ratios to GNP - (At 1977 prices, Million TL)

Years	GNP	Current Expend.	% GNP	Transfers	% GNP	Public Investments	% GNP	Total Public Expend.	% GNP
1982	4,369.5	988.1	22.6	370.9	8.5	215.0	4.9	1,574.0	36.0
1983	4,440.4	892.2	20.1	453.1	10.2	355.5	8.0	1,700.8	38.3
1984	4,725.2	1,032.6	21.9	507.2	10.7	387.6	8.2	1,927.4	40.8
1985	5,080.4	1,056.0	20.8	622.1	12.2	335.0	6.6	2,013.1	39.6
1986	5,324.1	1,122.3	21.1	696.7	13.1	343.4	6.4	2,162.4	40.6
1987	5,684.1	1,174.0	20.7	746.4	13.1	452.8	8.0	2,373.2	41.8
1988	6,084.0	1,201.8	19.8	645.6	10.6	271.2	4.5	2,118.6	34.8
1989	6,603.0	1,233.4	18.7	559.6	8.5	310.0	4.7	2,103.0	31.9
1990	6,977.4	1,579.4	22.6	756.1	10.8	461.3	6.6	2,796.8	40.1
1991	6,606.4	1,719.1	26.0	880.4	13.3	271.8	4.1	2,871.3	43.5
1992	7,124.7	1,604.6	22.5	827.2	11.6	377.2	5.3	2,809.0	39.4
1993	7,547.4	1,656.3	22.0	950.4	12.6	492.0	6.5	3,098.7	41.1
1994	7,268.3	1,729.2	23.8	1,000.6	13.8	356.6	4.9	3,086.4	42.5
1995	7,457.8	1,712.7	23.0	1,226.9	16.5	270.3	3.6	3,209.9	43.0
1996	7,673.4	1,717.2	22.4	1,184.7	15.4	502.2	6.5	3,404.1	44.4
1997	7,966.2	1,961.6	24.6	1,301.7	16.3	499.3	6.3	3,762.6	47.2
Results For the Period									
Total Change (%)		98.5	8.9	251.0	91.8	132.2	28.5	139.1	31.1
Yearly Average (%)		5.0	1.0	9.0	4.7	6.0	1.8	6.0	1.9
Period's Average (%)			22.0		12.3		5.9		40.3

--Shares are calculated by using the statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, 1998 Lefkoşa, Tables-1,15, pp 1, 24.

Transfers have increased from 370.9 Million TL in 1982 to 1,301.7 Million TL in 1997, at 1977constant prices. This result shows a total increase of 251% and a yearly average rise of 8.0% for the period.

The average share of the transfers in total public expenditures has been 30.4% for the period (Table-2.5). The ratio of transfers to GNP has increased from 8.5% in 1982 to 16.3% in 1997. This result shows a total increase of 91.8% and a yearly average rise of 4.3% in the ratio of transfers to GNP. The average ratio of transfers to GNP for the period has been 12.3% (Table-2.6). Composition of Public Expenditures of can be seen in Graph-2.2b.

It is obvious from Table-2.6 that public expenditures in general and transfer payments in particular have risen at a faster rate than the GNP during the period of 1982-1997. This situation is in accordance with the hypothesis which is often called *Wagner's Law*, after Adolph Wagner, the 19th century economist who formulated it.[23] Wagner's Law states that the public expenditure increases as the income level of a country increases.

3.3 Public Deficit

Public Deficit, which is the difference of public revenues and public expenditures, has increased from 793.8 Million TL in 1982 to 983.2 Million TL in 1997 at 1977 constant prices. This result shows a total increase of 23.9% and a yearly average rise of 1.4% for the period in real terms (Table2.2).

On the other hand, the ratio of public deficit to GNP has decreased from 18.1% in 1982 to 12.3% in 1997 (Table-2.7). This result shows a total decrease in the ratio of public deficit to GNP, of 32.0% and a yearly average decline of 2.6% within the period. In spite of the fact that this ratio has decreased in the period, we have to note that it is still preserving its existence significantly. Also, it is noticeable that in 1997, which is the last year of the period, the ratio of public deficit to total public revenues has been 35.4%.

[23] Harvey S. Rosen, op.cit., p.142.

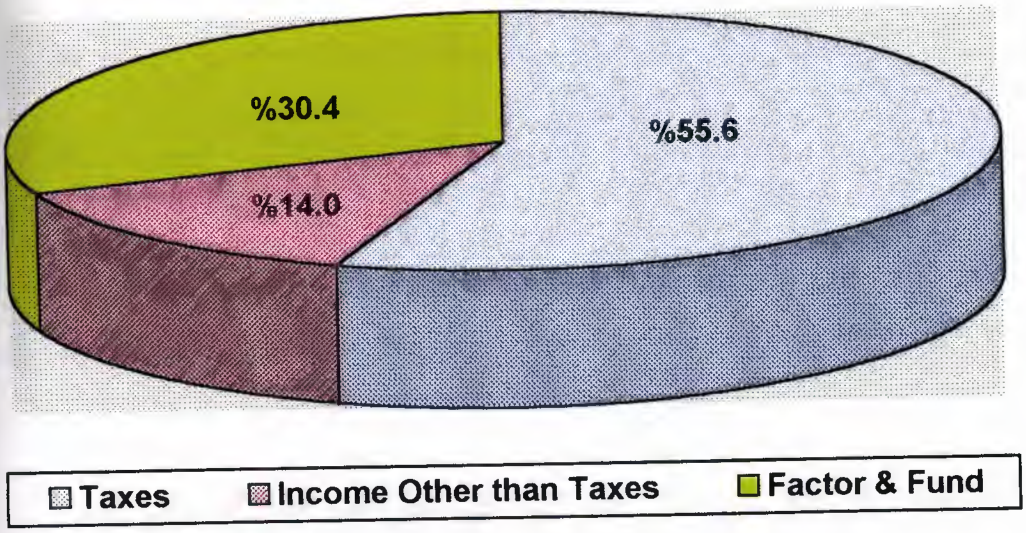
Table-2.7 Balance of Public Revenues and Expenditures
(At 1977 prices, Mil. TL and Shares in GNP)

Years	Total Public Revenues	% GNP	Total Public Expend.	% GNP	Public Deficit	% GNP
1982	780.2	17.9	1,574.0	36.0	-793.8	-18.1
1983	1,155.0	26.0	1,700.8	38.3	-544.8	-12.3
1984	1,281.3	27.1	1,927.4	40.8	- 646.1	-13.7
1985	1,289.1	25.4	2,013.1	39.6	-724.0	-14.2
1986	1,342.0	25.2	2,162.4	40.6	-820.4	-15.4
1987	1,851.0	32.6	2,373.2	41.8	-522.2	-9.2
1988	2,240.8	36.8	2,118.6	34.8	122.2	2.0
1989	2,081.3	31.5	2,103.0	31.9	21.7	0.4
1990	2,586.0	37.1	2,796.8	40.1	-210.3	-3.0
1991	2,484.4	37.6	2,871.3	43.5	-386.9	-5.9
1992	2,230.3	31.3	2,809.0	39.4	-578.7	-8.1
1993	2,611.8	34.6	3,098.7	41.1	-486.9	-6.5
1994	2,730.5	37.6	3,086.4	42.5	-355.9	-4.9
1995	2,279.7	30.6	3,209.9	43.0	-930.2	-12.4
1996	2,495.2	32.5	3,404.1	44.4	-908.9	-11.9
1997	2,779.5	34.9	3,762.6	47.2	-983.2	-12.3

--Shares are calculated by using the statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, 1998 Lefkoşa, Tables-1,15, pp 1, 24.

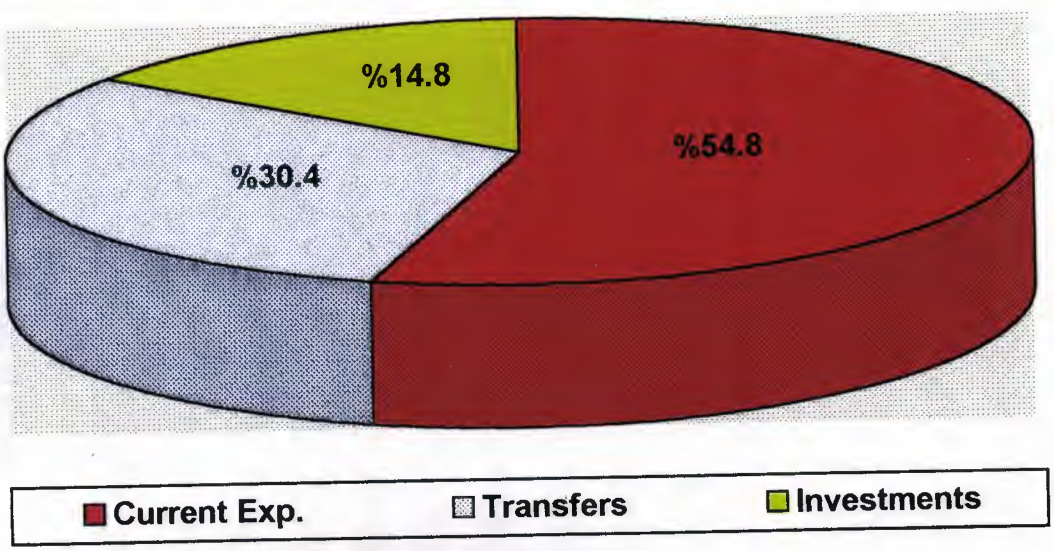
Evolution of Public Deficits together with the expenditures and the revenues in the TRNC can be seen in Graph-2.2a and Graph-2.2b. For preparing the Graphs 2.2a and 2.2.b, ratios of public revenues, expenditures and deficits to GNP have been plotted versus years for the period of 1982-1997.

Graph-2.1a Public Revenues



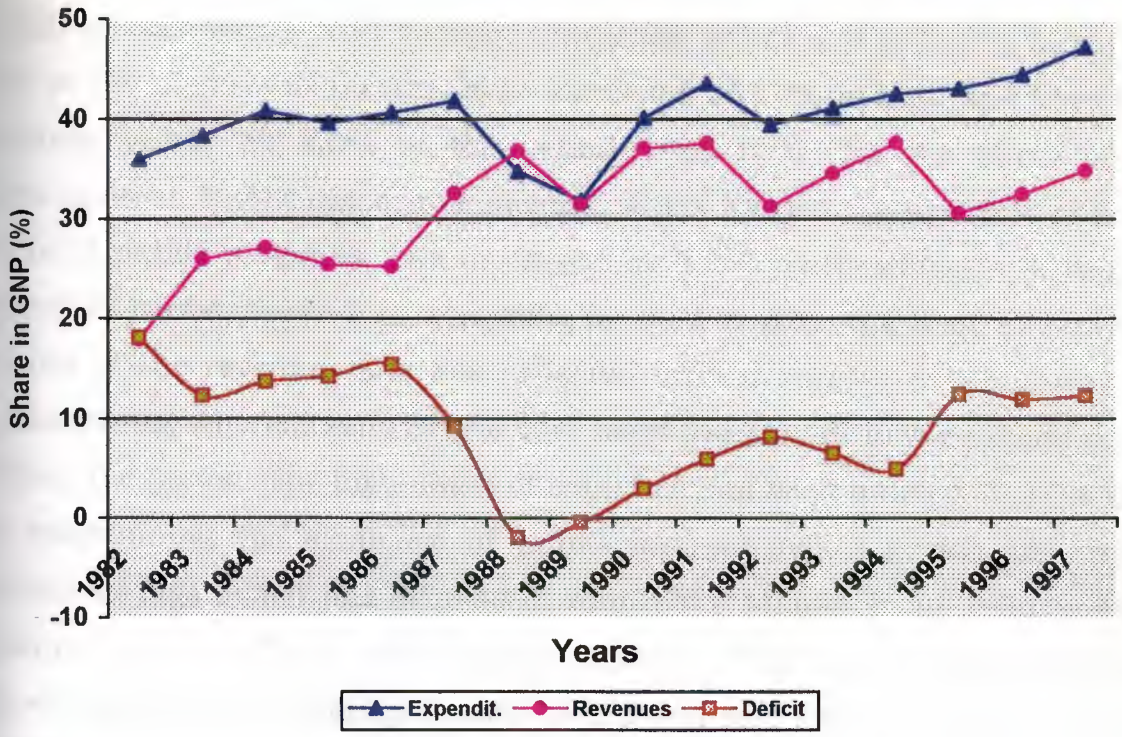
-- Period's average shares are plotted.

Graph-2.1b Public Expenditures

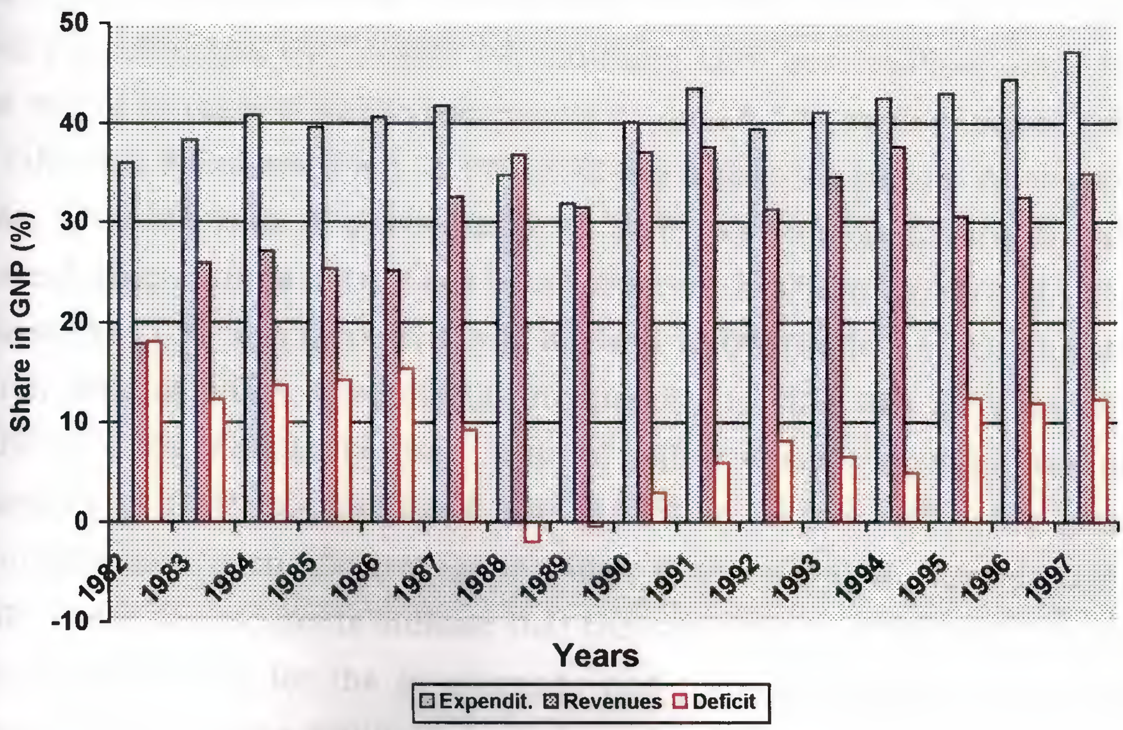


-- Period's average shares are plotted.

Graph-2.2a Evolution of Public Deficits of the TRNC



Graph-2.2b Evolution of Public Deficits of the TRNC



4. Conclusion

Analysis has shown that transfer payments, which are reducing factors for the public disposable income, have increased 251.0% in total and have risen average yearly by 8.0% in the period 1982-1997. By the effect of this development, Public disposable income, which has an average ratio of 61.0% to total public revenues, has increased by 9.0% yearly average, during the specified period (Table-2.2). According to these results, the state has directed 61.0% of the revenues she has collected, to her current expenditures and investments, whereas only 39.0% have been transferred to the private sector, within the period. The high share of transfers has been a determinative issue in maintaining the existence of public savings deficit during the period. Public savings deficit has decreased from 578.8 Million TL in 1982 to 483.9 Million TL in 1997, at 1977 constant prices, showing a total decrease of 16.4% and a yearly average decline of 1.0% in real terms, during the period (Table-2.2).

It is also seen that, public current expenditures have increased by 4.6% yearly average in real terms while public investments have increased by 5.6% yearly average in real terms during the period. As a result of the fact that rate of increase of current expenditures have been realized lower than the rate of increase of public revenues (4.6% and 8.5%), ratio of public deficit to GNP has decreased from 18.0% to 12.0% within the period. At the same time, while the ratio of public deficit to GNP has decreased, ratio of public current expenditures to GNP has increased from 23.0% to 25.0% and ratio of transfers to GNP has increased from 8.0% to 16.0% (Table-2.6). On the other hand, ratio of public fixed capital investments to GNP has increased from 5.0% to 6.o%. As can be seen, ratio of public current expenditures plus transfers to GNP has increased from 31.0% to 41.0% within the period. Transfers have been effective for the high share of public expenditures in GNP. These developments indicate that the state has reserved fewer share of revenues or funds for the investments and transfers formed a significant share of expenditures within the period.

As a result of the policies implemented during the period 1982-1997, public revenues have increased and the public deficit has decreased. But on the other hand, the aims of reducing the public expenditures and increasing the public investments, together with establishing a more efficient public sector and establishing a just tax system have not been achieved during the period. The objective of increasing the public revenues has been achieved at the expense of increasing the tax burden and restricting the investments.

By privatisation, the high share of the public sector in the economy will be reduced, private sector will be encouraged and efficiency will be increased. However, the process has not been completed yet, and the high burden of Public Enterprises still continues.

As known, public revenues plays a role in the formation and development of capital sources, while great importance is attached to the form of using the public expenditures from the aspects of accumulation of capital, production and employment. When we consider the structure and development of public expenditures in the TRNC, we can say that their contribution from the aspects of accumulation of capital and increasing production is very limited. Especially, the high share and the direction of development of transfers which, are not in return of production and services, show that the TRNC is deviating from the effective use of the public sources.

But on the other hand, we should not disregard the fact that transfer payments act like increases in autonomous spending in their effect on equilibrium income. Transfers raise autonomous consumption spending by the marginal propensity to consume.[24] An increase in transfer payments increases autonomous demand therefore increasing the income by the marginal propensity to consume. Also, it is another fact that transfer payments do not create any direct effect on national income, but only causes the transfer of purchasing power between the social sections or individuals.[25]

---

[24] Dornbush and Fischer, op.cit., p.70.

[25] Prof.Dr. Şevki ÖZBİLEN, op.cit., p.75.

III. THE BUDGET

1. Introduction

Fiscal activities of the government influence the economic and social life too. Because of this, fiscal activities of the government should be performed with care. Today, the use of fiscal policy tools directs economic and social life. Because of this, the budget is not only a tool for determining the public revenues and expenditures according to the public needs and finding sources for them, but also is an important tool for realising the planned growth and social structure while targeting the struggle against inflation. More briefly, budget is a legal document, stating the decisions and preferences about communal goods and services together with the sources and revenues.[26] Improvement of the infrastructure through the effective and efficient use of the national resources, increase in the production of goods and services, improvement of the distribution of income, expansion of social justice, overcoming the regional imbalances and increase in the level of public services are all targeted by the budget.

The budget has started to be used more as a tool due to the increase in public services and activities. It is also used to control the aggregate demand and supply equilibrium in the economy.

In Chapter II, general balance of the public sector has been examined and the fiscal policy tools are identified. Note that, not only the budget itself, but also the elements and sub-elements that set up the budget are the fiscal policy tools.

In this chapter, the evolution of the budget in the TRNC for the period 1977-1997 will be examined in detail, and the elements and the sub-elements of the budget will be studied separately for the structural analysis of the budget of the TRNC. The analysis will end with conclusions and comments.

[26] Şerafettin Aksoy, **KAMU MALİYESİ**, Filiz Kitabevi, 1998 İstanbul, p.386.

2. Structural Analysis of the TRNC Budget

The budget of TRNC is composed of three main elements. These are:

1- Budget Expenditures;

2- Budget Revenues;

3- Foreign Aid and Borrowings.[27]

2.1 Budget Expenditures of the TRNC

Characteristics and the level of budget expenditures are the determining elements for the development of a country. The state expenditures are effective in determining the use of sources by the state, the sources of income, the accumulation capital and the use of private sources. Specially, in attaining the targets and the aims set on production, in creating employment and price stability, budget expenditures can directly be used as an effective tool as mentioned in Chapter II.

Related with these characteristics, when we analyse budget expenditures part of the budget of the TRNC, we see that, they have risen from 1,186.1 million TL to 50,160,862.0 million TL between the years 1977 and 1997 with current prices, and from 1,186.1 million TL to 3,379.9 million TL at 1977 prices (Table-3.1, Table-3.2). According to these values, the budget expenditures have grown by 185.0% in real terms for the specified period. This is a 5.2% rise on the average, yearly.

When we compare the rise with respect to current and 1977 prices, it can easily be realized that economy of the TRNC has faced a high inflation between the specified years.

[27] KKTC Başbakanlık, DPÖ, **EKONOMİK VE SOSYAL GÖSTERGELER**, 1998 Lefkoşa, p.27.

Besides the effects it has created on the economy in general, high rate of price changes has also affected the budget. Nevertheless, the share of expenditures has shown a total of 11.2% rise, from 31.2% to 42.4% in GNP between the years 1977-1997.

Budget expenditures of the TRNC consist of four sub-elements. These are given below.

2.1.1 Current Expenditures

As mentioned in the previous chapter, current expenditures cover the highest share of the budget expenditures. They are the expenditures made on personnel wages and salaries. Also, the other current expenditures such as victuals, post, telephone and cleaning expenses, consumed goods and purchased supplies, fixtures and other payments are all done under this heading.[28]

Current expenditures have increased from 668 million TL to 20,375,173.6 million TL at current prices for the period 1977-1997 (Table-3.1). With constant prices the current expenses have risen from 668.0 to 1,372.9 million TL for the same period (Table-3.2).

According to the data, current expenditures have risen by 105.5% with constant prices, within the specified period. Average share of current expenditures in total budget expenditures has been realized as 48.2% for the specified period, where 40.1% of this is the share of personnel expenditures and 8.1% of this is the share of other current expenditures.

---

[28] Ekonomi ve Maliye Bakanlığı, op.cit., p.65.

2.1.2 Transfer Payments

The second biggest share of budget expenditures is realized by transfer payments. The transfer payments are made up of *social transfers*, and *other transfers* as explained in the previous chapter. Some examples of *social transfers* are pensions given to the pensioners, aid to the poor, scholarships, aid to the war veterans and to the martyr families. *Other transfers* are done in the form of financial transfers and economic transfers. Some examples of financial transfers are, aids to sports federations, to Turk Agency Kıbrıs , to political parties and contributions to the state radio and television BRTK and to religious institutions. Besides these, contributions to institution of agricultural crops (TÜK), transfers to municipalities and transfers to public enterprises for capital accumulation are the examples of economic transfers.

Transfer payments have shown a steady growth from 283.7 million TL to 19,359,870.8 million TL with current prices and at the same time with constant prices, they have risen from 283.7 million TL to 1,304.5 million TL. This is a total of 359.8% and on the average 7.6% rise yearly. At the same time, share of transfers in GNP has grown from 7.5% to 16.4%, which is a total of 118.7% and 3.9% rise yearly. Average share of the transfer payments in total budget expenditures has been realized as 33.3% for the period of 1977-1997.

2.1.3 Defence Expenditures

Security Troops and Civil Defence are the institutions that are responsible for defending the nation. Defence expenditures are composed of the current expenditures, investment projects and transfer payments for these institutions. Due to the fact that most of the defence work is taken over by Turkish Army who are financed by the Turkish state, not much expenditure is done for defence by the state of the TRNC. For the years 1977-1997, the defence expenditures have risen from 143.6 million TL to 4,325,000.0

million TL at current prices. When these figures are analysed at constant prices, it can be seen that they have fluctuated over the years. In fact, the share of defence in GNP has shown a steady decrease from 3.8% in 1977 to 1.9% in 1996 indicating a total of 50.0%, and 3.5% yearly decrease on the average. Then, a sudden increase from 1.9% to 3.6% in 1997 is observed. This is due to the financing of defence projects implemented after the co-operation protocol with Turkey in 1997. Average share of the defence expenditures in total budget expenditures has been realized as 6.9% for the period 1977-1997.

2.1.4 Investments

As explained in the previous chapter, in the budget of the TRNC, *investments* consists of the money spend on:

- Infrastructure for transportation and communication;
- Buildings for constructions and extensive restorations;
- Constructions and caring of water walls;
- Agriculture and forestry;
- Vehicles and machinery;
- Infrastructure for tourism and industry;
- Social services.

Investments have shown a steady growth for the years 1977-1997. With current prices, investments have grown from 90.8 million TL to 6,100,817.6 million TL. When we analyse investments at constant prices they have increased by a total of 352.8% from 90.8 million TL to 411.1 million TL indicating a 7.6% rise yearly. The share of investment expenditures in total budget expenditures has increased from 7.7% in 1977 to12.2% in 1997. At the same time, the share of investments in GNP has increased from 2.4 % to 5.2%. Average share of investment expenditures in the budget expenditures has been realized as 11.6% for the period 1977-1997.

The structural analysis shows that the share of current expenditures is too high compared with the other elements of budget expenditures (Table-3.4). The share of current expenditures has shown a steady decrease from 56.3% to 40.6% in total budget expenditures, although there has been 105.5% rise in the current expenditures between 1977 and 1997, at constant prices. On the average, 80% of all current expenditures go to personnel and the rest 20% is spent on other expenditures such as telephone, post, fixtures etc. Between the years 1977-1982, the share of other expenditures was 11.2%, whereas by the years 1983-1997, this share has declined to 6.9% on the average. In total, current expenditures, including both the personnel and the other expenditures, have declined. However, current expenditures' share is still higher than other budget expenditures. The main reason which causes the current expenditures share to be high is the fact that public sector is over employed and moreover, the state is still employing more people. When the statistics are analysed, the number of people employed by the state from 1977 to 1997 has shown a 25.0% increase from 13,076.0 to 16,972.0.[29] Although there has been a 25.0% increase, the share of public services in GNP has shown a decrease from 19.9% in 1977 to 17.1% by 1997.[30]

---

[29] KKTC Başbakanlık, DPÖ, **EKONOMİK VE SOSYAL GÖSTERGELER**, 1998 Lefkoşa, p.61.
[30] Ibid., p.6.

Table-3.1 BALANCE OF STATE REVENUES AND EXPENDITURES

(Current Prices, MillionTL)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
I. Local Revenues	627.1	799.7	1,267.6	1,992.0	3,449.9	4,559.1	8,638.8	13,159.1	21,496.0	33,281.0
1.Tax Revenues	408.0	598.0	815.1	1,397.4	2,592.8	3,489.1	6,723.1	10,578.7	17,580.0	26,329.5
a) Direct Taxes	135.9	183.4	281.7	447.4	990.2	1,515.0	2,895.1	5,004.5	8,592.0	14,496.3
b) Indirect Taxes	272.1	414.6	533.4	950.0	1,602.6	1,974.1	3,828.0	5,574.2	8,988.0	11,833.2
2. Other Income	219.7	201.7	452.5	594.6	857.1	1,070.0	1,915.7	2,580.4	3,916.0	6,951.5
3. Fund Revenues	-	-	-	-	-	-	-	-	-	-
II. Expenditures	1,186.1	1,435.3	2,394.0	4,209.2	7,219.8	9,690.2	16,274.2	26,964.0	45,788.7	70,474.0
1. Current Expenditures	668.0	776.6	1,314.3	2,422.0	3,795.6	4,401.0	7,575.1	12,405.9	20,167.5	32,418.2
a) Personal Expenditures	553.3	627.1	991.5	1,971.1	3,012.1	3,271.8	6,032.0	10,262.7	17,229.9	27,676.0
b) Other Current Expenditure	114.7	149.5	322.8	450.9	783.5	1,129.2	1,543.1	2,143.2	2,937.6	4,742.2
2. Transfers	283.7	406.6	741.0	1,063.3	1,698.0	2,899.0	4,801.1	7,935.7	15,534.8	25,529.7
a) Social Transfers	-	-	560.7	674.6	1,238.5	2,248.0	3,358.8	5,081.8	10,336.0	15,594.1
b) Other Transfers	-	-	180.3	388.7	459.5	651.0	1,442.3	2,853.9	5,198.8	9,935.6
3. Defence	143.6	124.9	198.9	325.8	548.6	757.9	1,261.7	2,537.9	3,598.4	4,982.0
4. Investments	90.8	127.2	139.8	398.1	1,177.6	1,632.3	2,636.3	4,079.5	6,488.0	7,544.1
III. Foreign Aid And Loans	558.4	635.6	1,126.4	2,217.2	3,769.9	5,131.1	7,635.4	13,804.9	24,292.7	37,193.0
1. Foreign Aid	193.6	271.6	425.0	645.6	1,745.1	2,274.3	3,912.7	7,015.1	11,787.9	14,607.6
a) Aid From Turkey	193.6	220.5	374.1	606.6	1,720.7	2,236.6	3,866.2	6,961.8	10,450.9	11,701.7
b) Other Foreign Aid	-	51.1	50.9	39.0	24.4	37.7	46.5	53.3	1,337.0	2,905.9
2. Loans	364.8	364.0	701.4	1,571.6	2,024.8	2,856.8	3,722.7	6,789.8	12,504.8	22,585.4
a) Internal Loans	88.8	74.7	34.8	30.3	-	-	-	-	3,754.8	4,585.4
b) Foreign	276.0	289.3	666.6	1,541.3	2,024.8	2,856.8	3,722.7	6,789.8	8,750.0	18,000.0
GNP	3,810.5	5,251.0	8,504.5	17,541.5	24,525.6	34,148.0	47,040.2	73,937.8	126,874.2	195,142.7

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
I. Local Revenues	59,034.0	109,183.3	195,748.7	390,329.1	521,869.3	876,946.5	1,689,502.0	4,748,525.1	8,463,386.0	15,528,392.7	34,385,089.9
1.Tax Revenues	48,246.9	90,713.0	162,989.3	331,717.8	425,804.3	728,738.0	1,392,382.4	3,129,140.4	6,202,681.8	11,366,588.0	25,100,952.4
a) Direct Taxes	26,227.4	47,205.7	84,424.3	166,109.9	243,580.9	392,651.3	727,805.0	1,813,865.8	3,661,102.4	6,518,720.4	14,161,807.2
b) Indirect Taxes	22,019.5	43,507.3	78,565.0	165,607.9	182,223.4	336,086.7	664,577.4	1,315,274.6	2,541,579.4	4,847,867.6	10,939,145.2
2. Other Income	10,787.1	18,470.3	32,759.4	58,611.3	96,065.0	148,208.5	297,119.6	757,998.0	1,609,116.6	3,138,274.4	6,551,492.3
3. Fund Revenues	-	-	-	-	-	-	-	861,386.7	651,587.6	1,023,530.3	2,732,645.2
II. Expenditures	106,054.3	150,702.2	257,142.9	524,749.0	891,063.2	.369,323.9	2,504,274.9	6,260,479.1	13,655,393.2	24,380,624.4	50,160,862.0
1. Current Expenditures	45,966.5	75,886.9	129,114.0	247,636.2	400,163.9	654,652.1	1,162,462.7	3,037,803.5	6,263,359.4	10,671,604.0	20,375,173.6
a) Personal Expenditures	39,041.3	65,663.5	108,093.1	206,942.8	341,748.5	557,737.0	973,752.4	2,669,305.3	5,509,473.8	9,275,954.3	17,756,985.3
b) Other Current Expenditure	6,952.2	10,223.4	21,020.9	40,693.4	58,415.4	96,915.1	188,710.3	368,498.2	753,885.6	1,395,649.7	2,618,188.3
2. Transfers	37,954.4	55,222.3	85,584.6	182,573.9	331,505.7	496,217.1	901,119.5	2,303,510.4	5,794,161.5	9,867,171.5	19,359,870.8
a) Social Transfers	25,315.5	36,675.3	64,262.9	144,852.1	231,674.0	398,854.7	693,920.0	1,821,121.8	5,002,953.9	7,682,524.6	13,945,813.8
b) Other Transfers	12,638.9	18,547.0	21,321.7	37,721.8	99,831.7	97,362.4	207,199.5	482,388.6	791,207.6	2,184,646.9	5,414,057.0
3. Defence	5,980.0	8,564.7	12,550.0	20,140.0	46,975.0	84,150.0	126,100.0	310,265.8	747,500.0	1,247,500.0	4,325,000.0
4. Investments	16,153.4	11,028.3	29,894.3	74,398.9	112,418.6	134,304.7	314,592.7	608,899.4	850,372.3	2,594,348.9	6,100,817.6
III. Foreign Aid And Loans	47,020.3	41,518.9	61,394.2	134,419.9	369,193.9	492,377.4	814,772.9	1,511,954.0	5,192,007.2	8,852,231.7	15,775,772.1
1. Foreign Aid	25,902.4	22,132.4	37,192.9	50,884.9	113,680.3	150,698.5	296,341.6	632,062.4	1,294,957.6	6,226,437.9	12,281,476.4
a) Aid From Turkey	19,942.6	15,455.0	33,297.3	48,988.6	109,767.6	149,212.7	294,885.0	621,234.9	1,253,647.9	6,119,642.4	12,171,847.1
b) Other Foreign Aid	5,959.8	6,677.4	3,895.6	1,896.3	3,912.7	1,485.8	4,456.6	10,827.5	41,309.7	106,795.4	109,629.3
2. Loans	21,117.9	19,386.5	24,201.3	83,535.0	255,513.6	341,678.9	518,431.3	879,891.6	3,897,049.6	2,625,793.8	3,494,295.7
a) Internal Loans	11,117.9	19,386.5	24,201.3	73,535.0	156,813.6	237,121.8	517,321.7	879,891.6	3,897,049.6	2,125,793.8	3,494,295.7
b) Foreign	10,000.0	-	-	10,000.0	98,700.0	104,557.1	1,109.6	-	-	500,000.0	-
GNP	289,106.4	485,848.2	910,058.6	1,547,793.0	2,273,698.1	,037,702.2	6,941,224.3	6,941,224.3	35,178,971.7	63,576,940.3	118,227,359.0

Source:KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-18, 1998 Lefkoşa, pp.27,28.

Table-3.2 BALANCE OF STATE REVENUES AND EXPENDITURES

(1977 Prices, Million TL)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
I. Local Revenues	627.7	610.3	627.6	482.5	552.8	583.4	815.5	841.0	860.8	908.0	1,160.7	1,367.2	1,420.3	1,759.6	1,516.3	1,547.4	1,837.1	2,081.5	1,794.2	1,874.2	2,316.9
1. Tax Revenues	408.0	456.4	403.6	338.5	415.4	446.5	634.6	676.1	704.0	718.3	948.6	1,135.9	1,182.6	1,495.4	1,237.2	1,285.9	1,514.0	1,371.6	1,314.9	1,371.9	1,691.3
a) Direct Taxes	135.9	140.0	139.5	108.4	158.6	193.9	273.3	319.9	344.1	395.5	515.7	591.1	612.6	748.8	707.7	692.9	791.4	795.1	776.1	786.8	954.2
b) Indirect Taxes	272.1	316.4	264.1	230.1	256.8	252.6	361.3	356.2	359.9	322.8	432.9	544.8	570.0	746.6	529.5	593.0	722.6	576.5	538.8	585.1	737.1
2. Other Income	219.7	153.9	224.0	144.0	137.4	136.9	180.9	164.9	156.8	189.7	212.1	231.3	237.7	264.2	279.1	261.5	323.1	332.3	341.1	378.8	441.5
3. Fund Revenues	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	377.6	138.2	123.5	184.1
II. Expenditures	1,186.1	1,095.3	1,185.3	1,019.5	1,156.8	1,240.0	1,536.2	1,723.2	1,833.5	1,922.8	2,085.2	1,887.1	1,865.7	2,365.6	2,589.0	2,416.2	2,723.0	2,744.2	2,894.9	2,942.6	3,379.9
1. Current Expenditures	668.0	592.6	650.7	586.6	608.1	563.2	715.1	793.1	807.5	884.5	903.8	950.3	936.8	1,116.4	1,162.7	1,155.1	1,264.0	1,331.6	1,327.8	1,288.0	1,372.9
a) Personal Expenditures	553.3	478.5	490.9	477.4	482.6	418.7	569.4	655.8	689.9	755.1	767.6	822.3	784.3	932.9	993.0	984.1	1,058.8	1,170.1	1,168.0	1,119.6	1,196.5
b) Other Current Expenditures	114.7	114.1	159.8	109.2	125.5	144.5	145.7	137.3	117.6	129.4	136.2	128.0	152.5	183.5	169.7	171.0	205.2	161.5	159.8	168.4	176.4
2. Transfers	283.7	310.3	366.9	257.6	272.1	370.9	453.2	507.2	622.1	696.5	746.2	691.5	621.0	823.0	963.2	875.6	979.8	1,009.7	1,228.3	1,190.9	1,304.5
a) Social Transfers	-	-	277.6	163.4	198.5	287.6	317.1	324.8	413.9	425.4	497.7	459.3	466.3	653.0	673.1	703.8	754.5	798.3	1,060.6	927.2	939.7
b) Other Transfers	-	-	89.3	94.2	73.6	83.3	136.1	182.4	208.2	271.1	248.5	232.2	154.7	170.0	290.1	171.8	225.3	211.4	167.7	263.7	364.8
3. Defence	143.6	95.3	98.5	78.9	87.9	97.0	119.1	162.2	144.1	135.9	117.6	107.2	91.0	90.8	136.5	148.5	137.1	136.0	158.5	150.6	291.4
4. Investments	90.8	97.1	69.2	96.4	188.7	208.9	248.8	260.7	259.8	205.8	317.6	138.1	216.9	335.4	326.6	237.0	342.1	266.9	180.3	313.1	411.1
III. Foreign Aid And Loans	558.4	485.0	557.7	537.0	604.0	656.6	720.7	882.2	972.7	1,014.8	924.5	519.9	445.4	606.0	1,072.7	868.8	885.9	662.7	1,100.7	1,068.4	1,063.0
1. Foreign Aid	193.6	207.3	210.4	156.4	279.6	291.0	369.3	448.3	472.0	398.6	509.3	277.1	269.8	229.4	330.3	265.9	322.2	277.0	274.5	751.5	827.5
a) Aid From Turkey	193.6	168.3	185.2	146.9	275.7	286.2	364.9	444.9	418.5	319.3	392.1	193.5	241.6	220.8	318.9	263.3	317.4	272.3	265.8	738.6	820.1
b) Other Foreign Aid	-	39.0	25.2	9.5	3.9	4.8	4.4	3.4	53.5	79.3	117.2	83.6	28.2	8.6	11.4	2.6	4.8	4.7	8.7	12.9	7.4
2. Loans	364.8	277.7	347.3	380.6	324.4	365.6	351.4	433.9	500.7	616.2	415.2	242.8	175.6	376.6	742.4	602.9	563.7	385.7	826.2	316.9	235.5
a) Internal Loans	88.8	57.0	17.2	7.3	-	-	-	-	150.3	125.1	218.6	242.8	175.6	331.5	455.6	418.4	562.5	385.7	826.2	256.6	235.5
b) Foreign Loans	276.0	220.7	330.1	373.3	324.4	365.6	351.4	433.9	350.4	491.1	196.6	-	-	45.1	286.8	184.5	1.2	-	-	60.3	-
GNP	3,810.5	4,031.3	4,210.1	4,248.4	3,929.8	4,369.5	4,440.4	4,725.2	5,080.4	5,324.1	5,684.1	6,084.0	6,603.0	6,977.4	6,606.4	7,124.7	7,547.4	7,268.3	7,457.8	7,673.4	7,966.2

Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-19, 1998 Lefkoşa, pp.29.30.

Table-3.3 BALANCE OF STATE REVENUES AND EXPENDITURES

(Share in GNP)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
I. Local Revenues	16.5	15.1	14.9	11.4	14.0	13.4	18.4	17.8	16.9	17.0	20.4	22.5	21.5	25.2	23.0	21.7	24.3	28.6	24.0	24.4	29.1
1.Tax Revenues	10.7	11.3	9.6	8.0	10.5	10.3	14.3	14.3	13.9	13.5	16.7	18.7	17.9	21.4	18.7	18.0	20.0	18.8	17.6	17.9	21.3
a) Direct Taxes	3.6	3.5	3.3	2.6	4.0	4.5	6.2	6.8	6.8	7.4	9.1	9.7	9.3	10.7	10.7	9.7	10.5	10.9	10.4	10.3	12.0
b) Indirect Taxes	7.1	7.8	6.3	5.4	6.5	5.8	8.1	7.5	7.1	6.1	7.6	9.0	8.6	10.7	8.0	8.3	9.5	7.9	7.2	7.6	9.3
2. Other Income	5.8	3.8	5.3	3.4	3.5	3.1	4.1	3.5	3.0	3.5	3.7	3.8	3.6	3.8	4.3	3.7	4.3	4.6	4.6	4.9	5.5
3. Fund Revenues	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	5.2	1.8	1.6	2.3
II. Expenditures	31.2	27.2	28.1	24.0	29.4	28.4	34.6	36.5	36.1	36.1	36.7	31.0	28.3	33.9	39.2	33.9	36.0	37.8	38.8	38.3	42.4
1. Current Expenditures	17.5	14.7	15.5	13.8	15.5	12.9	16.1	16.8	15.9	16.6	15.9	15.6	14.2	16.0	17.6	16.2	16.7	18.3	17.8	16.8	17.2
a) Personal Expenditures	14.5	11.9	11.7	11.2	12.3	9.6	12.8	13.9	13.6	14.2	13.5	13.5	11.9	13.4	15.0	13.8	14.0	16.1	15.7	14.6	15.0
b) Other Current Expenditures	3.0	2.8	3.8	2.6	3.2	3.3	3.3	2.9	2.3	2.4	2.4	2.1	2.3	2.6	2.6	2.4	2.7	2.2	2.1	2.2	2.2
2. Transfers	7.5	7.7	8.7	6.0	6.9	8.5	10.2	10.7	12.2	13.1	13.1	11.4	9.4	11.8	14.6	12.3	13.0	13.9	16.5	15.5	16.4
a) Social Transfers	-	-	6.6	3.8	5.0	6.6	7.1	6.9	8.1	8.0	8.7	7.6	7.1	9.4	10.2	9.9	10.0	11.0	14.2	12.1	11.8
b) Other Transfers	-	-	2.1	2.2	1.9	1.9	3.1	3.8	4.1	5.1	4.4	3.8	2.3	2.4	4.4	2.4	3.0	2.9	2.3	3.4	4.6
3. Defence	3.8	2.4	2.3	1.9	2.2	2.2	2.7	3.5	2.9	2.5	2.1	1.7	1.4	1.3	2.1	2.1	1.7	1.9	2.1	1.9	3.6
4. Investments	2.4	2.4	1.6	2.3	4.8	4.8	5.6	5.5	5.1	3.9	5.6	2.3	3.3	4.8	4.9	3.3	4.5	3.7	2.4	4.1	5.2
III. Foreign Aid And Loans	14.7	12.1	13.2	12.6	15.4	15.0	16.2	18.7	19.2	19.1	16.3	8.5	6.8	8.7	16.2	12.2	11.7	9.2	14.8	13.9	13.3
1. Foreign Aid	5.1	5.2	5.0	3.7	7.1	6.7	8.3	9.5	9.3	7.5	9.0	4.5	4.1	3.3	5.0	3.7	4.3	3.8	3.7	9.8	10.4
2. Loans	9.6	6.9	8.2	8.9	8.3	8.3	7.9	9.2	9.9	11.6	7.3	4.0	2.7	5.4	11.2	8.5	7.4	5.4	11.1	4.1	2.9

Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-20, 1998 Lefkoşa, p.31.

Table-3.4 Budget Expenditures (At 1977 prices, Million TL)

Years	Personnel Exp.	%	Transfers	%	Defence Exp.	%	Investment	%	Other Exp.	%	Total (%100)
1977	553.3	46.6	283.7	23.9	143.6	12.1	90.8	7.7	114.7	9.7	1,186.1
1978	478.5	43.7	310.3	28.3	95.3	8.7	97.1	8.9	114.1	10.4	1,095.3
1979	490.9	41.4	366.9	31.0	98.5	8.3	69.2	5.8	159.8	13.5	1,185.3
1980	477.4	46.8	257.6	25.3	78.9	7.7	96.4	9.5	109.2	10.7	1,019.5
1981	482.6	41.7	272.1	23.5	87.9	7.6	188.7	16.3	125.5	10.9	1,156.8
1982	418.7	33.8	370.9	29.9	97.0	7.8	208.9	16.8	144.5	11.7	1,240.0
1983	569.4	37.0	453.2	29.5	119.1	7.8	248.8	16.2	145.7	9.5	1,536.2
1984	655.8	38.1	507.2	29.4	162.2	9.4	260.7	15.1	137.3	8.0	1,723.2
1985	689.9	37.6	622.1	33.9	144.1	7.9	259.8	14.2	117.6	6.4	1,833.5
1986	755.1	39.3	696.5	36.2	135.9	7.1	205.8	10.7	129.4	6.7	1,922.8
1987	767.6	36.8	746.2	35.8	117.6	5.7	317.6	15.2	136.2	6.5	2,085.2
1988	822.3	43.6	691.5	36.6	107.2	5.7	138.1	7.3	128.0	6.8	1,887.1
1989	784.3	42.0	621.0	33.3	91.0	4.9	216.9	11.6	152.5	8.2	1,865.7
1990	932.9	39.4	823.0	34.8	90.8	3.8	335.4	14.2	183.5	7.8	2,365.6
1991	993.0	38.3	963.2	37.2	136.5	5.3	326.6	12.6	169.7	6.6	2,589.0
1992	984.1	40.7	875.6	36.2	148.5	6.2	237.0	9.8	171.0	7.1	2,416.2
1993	1,058.8	38.9	979.8	36.0	137.1	5.0	342.1	12.6	205.2	7.5	2,723.0
1994	1,170.1	42.6	1,009.7	36.8	136.0	5.0	266.9	9.7	161.5	5.9	2,744.2
1995	1,168.0	40.4	1,228.3	42.4	158.5	5.5	180.3	6.2	159.8	5.5	2,894.9
1996	1,119.6	38.0	1,190.9	40.5	150.6	5.1	313.6	10.7	168.4	5.7	2,942.6
1997	1,196.5	35.4	1,304.5	38.6	291.4	8.6	411.1	12.2	176.4	5.2	3,379.9

--The shares are calculated by using the statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-19, 1998 Lefkoşa, pp.28,29.

This shows us that there is not a positive correlation between the increase in the number of people employed and the productivity of the public sector. So, high personnel expenditures, continuous increase in employment in public sector and also a high share of employment in the labour force, 20.4% in 1997, creates a high pressure on the budget expenditures.

At the same time, the share of transfer payments has increased from 23.9% in 1977 to 38.6% in 1997. One of the main reasons, which cause the share of transfer payments to increase, is the fact of early retirement law allowing people to retire with a 25 years work. This issue pushes up the social transfers so that people at the age of 50 can retire.

Although it has been stated by the Economic Co-operation Protocol signed with Turkey (1997), that the retirement payments for the state personnel would be taken out of the budget as a complementary measure for "single social security" system, preparations in this aspect have not been completed yet. The financial resources fulfilled by Turkey for this purpose have been used for meeting the short run resource needs and for meeting the budget deficits.[31]

It is obvious that the retirement payments must be taken out of the budget and the "single social security" system must follow at once; otherwise the practice of using the stated financial resource for other irrelevant purposes will lead to the prolongation of the problem.

On the other hand the fund given to the personnel as cost of living allowance under financial transfers is growing at an increasing rate due to inflation. Moreover, the municipalities also have high demands for aid from the central government. This has forced the economic transfers to be increased also.

All these mentioned factors, have made the share of transfer payments to grow to 38.6% of the budget which is nearly the amount spent on personnel working in the state. In the specified period, the share of defence has steadily declined from 12.1% in 1977 to 5.0% in 1993; and after the economic co-operation protocol with Turkey at the beginning of the year 1997. There has been a sudden increase to 8.6% in 1997. As mentioned before, this is due to the extensive implementation of the defence projects.

In general, the structure of the budget expenditures is not diverted to production and employment. The applied budget years 1977 to 1997 shows that the share of personnel, defence and the other current expenditures cover 51.1% of total expenditures on the average. At the same time, transfers have reached to 38.6%in 1977 and only 12.2% of total expenditures are allocated to investments from the budget. State personnel and the rise in personnel salaries increases the share of personnel expenditures. The rise in state employment is not only related to the progress of increases in public services. Due to the TRNC's special conditions, where the private sector is not developed enough to create employment and also in order to prevent

[31] KKTC Başbakanlık, DPÖ, 1999 **GEÇİŞ YILI PROGRAMI**, 1998 Lefkoşa, p.51.

young people from leaving the country (brain drain) and prevent unemployment and the consequent social unrest, state employs people without work. Therefore, finding a job in the public sector is not always related to the numerical or qualifying developments of the public sector. These issues worsen the situation of the public sector and it increases the expenditures of the budget and the cost of alternative financing.

In summing, the budget expenditures have shown an increasing tendency. The statistics shows to us that transfers are being the effective element in the rises of the budget expenditures. Unfortunately, the transfer payments are made without acquiring goods and services in return. This keeps the structure away from production, and directs it towards a poor production qualified budget. Even worse about the budget is the fact that, the total local revenues are not sufficient enough to meet current expenditures and transfer payments. In 1997, the total local revenues are 34,358,089.9 (at current prices) million TL, where the total of current expenditures and the transfers reach 39,735,044.4 million TL which is 5,376,955.5 million more than the revenues. This proves to us that the state has to borrow in order to pay its personnel and transfers. The investments are totally dependent both on the borrowings and the aid.

2.2 Budget Revenues of the TRNC

A state's ability to be alloyed to country's economy depends on the generated revenues and the ability to increase them. A country, which does not possess these characteristics, should not expect to be alloyed to the social and economical life of that country. In the budget of the TRNC, the revenues are collected under the heading of "Budget Local Revenues".

Local revenue part of the budget consists of three parts:

1) Tax revenues
2) Other income (revenues);
3) Fund revenues.[32]

---

[32] KKTC Başbakanlık, DPÖ, **EKONOMİK VE SOSYAL GÖSTERGELER**, 1998 Lefkoşa, p.27.

2.2.1 Tax Revenues

Tax revenues are made up of direct and indirect taxes. Direct taxes cover the income tax, charges from vehicles and driving licenses, institutions' tax, property tax and inheritance tax. Indirect taxes cover customs tax, Bank and insurance operations tax and value added tax.

With respect to the above definitions, the total tax revenues have increased from 408.0 million TL to 25,100,925.4 million TL at current prices between 1977 and 1997 (Table-3.2). At the same time, they have shown a 314.5% rise at constant prices from 408.0 million TL to 1,691.3 million TL during the same period (Table-3.1).

Due to the rise in tax revenues, the share of tax revenues has grown from 10.7% to 21.3% in GNP. This shows to us that the tax revenues have doubled. At the same period, the share of direct taxes have shown a 233.3% rise from 3.6% to 12.0% with respect to GNP. On the other hand, indirect tax ratio to GNP has grown from 7.1 to 9.3%. In the specified period the share of direct Taxes in GNP have followed a faster rise when compared to the share of indirect taxes. Together with these, the rate of increase of direct taxes has been within the growth limits in GNP (Table-3.3). Average share of total tax revenues in total local revenues has been 76.7% for the period. Average share of direct taxes in total local revenues has been 37.1%, whereas that of indirect taxes has been 39.6% for the period 1977-1997.

For establishing a modern and just tax structure, which will cover the whole economy, the Value Added Tax (VAT) law has been put in operation in 1996. By the enactment of this law, widening the coverage of taxes, reducing the losses in tax revenues and providing justice in the distribution of taxes have been targeted. There have been significant losses in the tax revenues in 1996 because of rearrangements in the other taxes and funds and also because the people were unfamiliar with VAT. But the positive results of the implementation of VAT law have affected the whole tax structure of the TRNC in 1997. The share of tax revenues in GNP has increased to 21.3% in

1997 from 17.9% in 1996, which means a 19.0% increase in tax revenues (Table-3.3). When we consider the development in indirect taxes, we see that the share of indirect taxes in GNP has increased to 9.3% in 1997 from 7.6% in 1996 indicating a total increase of 22.4% (Table-3.3).

2.2.2 Other Income

The budget of TRNC includes some revenues, which can not be classified as taxes. These include revenues from fees (e.g. import export certificate fee, passport fee and court fee), revenues from the services provided (e.g. postal charges, fines and confiscation), revenues from public economic enterprises (mainly from Cypruvex), revenues from treasury property rents and various revenues (such as contributions of the state personnel). For more detail about the coverage of Other Income, previous chapter can be seen.

Other Income (Revenues) show increases from 219.7 million TL to 6,551,492.3 million TL at current prices. At the same time, these revenues have grown from 219.7 million TL in 1977 to 441.5 million TL in 1997 at constant prices. This means a total of 101.0% and 3.5% yearly increase, with respect to 1977 prices. Even though there have been rises in revenues at constant prices, their share in GNP has shown a steady decrease from 5.8% to 5.5% in the specified period. Average share of other income in total local revenues has been 21.4% for the period 1977-1997.

2.2.3 Fund Revenues

As mentioned in the previous chapter, the law passed in 1992 and the statutes applied in 1993, have allowed the budget to use funds as revenues, starting from 1994's budget. Hence 50 % of:

- Foreign exchange stability fund,
- Price stability fund, and
- 10% of Tourism encouragement fund

(To be transferred to state budget), are used as revenues.

For more detailed information about the types of fund revenues used, previous chapter can be seen.

A steady decrease in fund revenues has followed from the year of its implementation, 1994, to 1997. Fund revenues have decreased from 377.6 million TL in 1994 to 184.1 million TL in 1997 at 1977 constant prices (Table-3.2). This is equivalent to a total decrease of 51.2% during the period 1994-1997. These values show to us that the fund revenues have followed a 23.9% yearly average decrease in the specified period. Average share of fund revenues in total local revenues has been 1.9% for the period 1977-1997.

The share of Fund revenues in GNP has decreased from 5.2% in 1994 to 2.3% in 1997 showing a decrease of 56.6% in total (Table-3.3). This result indicates a yearly average decrease of 27.2% in the share of fund revenues in GNP. The decline in the fund revenues is mainly due to the continuous losses of "Cypruvex Public Enterprises".[33]

On one hand, it seems economically logical to have such funds, as they will be used for improving the infrastructure, for the protection of producers and for the promotion of tourism. But on the other hand, it is well known that these funds are not used for fulfilling the objectives they are implemented for, but are used for financing the current expenditures or budget deficits.

Local revenues of the TRNC have shown a changing structure in their composition. Share of direct taxes for the years 1977 and 1981 has not even reached to the 30.0% of total local revenues whereas indirect taxes have been realized over 40.0% during the same period (Table-3.5). Especially between the years 1981 and 1986, the share of direct taxes has grown so fast, reaching 43.5 % in 1986. As a result of rises in the share of direct taxes, the composition of budget revenues has changed. On one hand, there has been a decrease in indirect taxes from 43.4% in 1977 to 31.8% in 1997 while on the other hand, other income has steadily decreased from 35.0% in 1977 to 19.1% in 1997.

[33] KKTC Başbakanlık, **DPÖ, 1998 GEÇİŞ YILI PROGRAMI**, 1997 Lefkoşa, p.39.

Table-3.5 Total Local Revenues (At 1977 prices, Million TL)

Years	Direct Taxes	%	Indirect Taxes	%	Total Tax Revenues	%	Other Income	%	Fund Revenues	%	Total Revenues
1977	135.9	21.7	272.1	43.3	408.0	65.0	219.7	35.0	-	-	627.7
1978	140.0	23.0	316.4	51.8	456.4	74.8	153.9	25.2	-	-	610.3
1979	139.5	22.2	264.1	42.1	403.6	64.3	224.0	35.7	-	-	627.6
1980	108.4	22.5	230.1	47.7	338.5	70.2	144.0	29.8	-	-	482.5
1981	158.6	28.7	256.8	46.5	415.4	75.2	137.4	24.8	-	-	552.8
1982	193.9	33.2	252.6	43.3	446.5	76.5	136.9	23.5	-	-	583.4
1983	273.3	33.5	361.3	44.3	634.6	77.8	180.9	22.2	-	-	815.5
1984	319.9	38.0	356.2	42.4	676.1	80.4	164.9	19.6	-	-	841.0
1985	344.1	40.0	359.9	41.8	704.0	81.8	156.8	18.2	-	-	860.8
1986	395.5	43.6	322.8	35.6	718.3	79.2	189.7	20.8	-	-	908.0
1987	515.7	44.4	432.9	37.3	948.6	81.7	212.1	18.2	-	-	1,160.7
1988	591.1	43.2	544.8	39.9	1,135.9	83.1	231.3	16.9	-	-	1,367.2
1989	612.6	43.1	570.0	40.1	1,182.6	83.2	237.7	16.8	-	-	1,420.3
1990	748.8	42.6	746.6	42.4	1,495.4	85.0	264.2	15.0	-	-	1,759.6
1991	707.7	46.7	529.5	34.9	1,237.2	81.6	274.1	18.4	-	-	1,516.3
1992	692.9	44.8	593.0	38.3	1,285.9	83.1	261.5	16.9	-	-	1,547.4
1993	791.4	43.1	722.6	39.3	1,514.0	82.4	323.1	17.6	-	-	1,837.1
1994	795.1	38.2	576.5	27.7	1,371.6	65.9	332.3	16.0	377.6	18.1	2,081.5
1995	776.1	43.3	538.8	30.0	1,314.9	73.3	341.1	19.0	138.2	7.7	1,794.2
1996	786.8	42.0	585.1	31.2	1,371.9	73.2	378.8	20.2	123.5	6.6	1,874.2
1997	954.2	41.2	737.1	31.8	1,691.3	73.0	441.5	19.1	184.1	7.9	2,316.9

--Shares are calculated by using the statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-19, 1998 Lefkoşa, pp.28,29.

In general, the composition of the revenues shows to us that the burden of tax is increasing. In 1977, the share of total tax revenues in total local revenues was only 65.0% whereas this has reached 73.0% in 1997.

However, in spite of this, even while the burden of the tax is increasing, the share of the tax revenues in national income has not shown a proportionate increase with respect to the increase in the tax burden (Table-3.3). It is a general tendency to see that the share of tax increases in national income together with economic and social developments. The share of tax revenues has been 15.4% on the average for the period 1977-1997 in GNP. The main reason, which causes the burden of tax to be low, is the fact that the share of direct tax is only 7.7% on the average for the period 1977-1997 in GNP. This result shows to us that, revenues other than wages and salaries paid by the state, are not taxed efficiently and effectively. In other words, there are some incomes, which are not taxed properly or not taxed at all.

When we consider the fact that propensity to invest is low in the TRNC, we can also see those revenues, which are underrated and not channelled to investments sufficiently. In other words, fiscal evasions are not turned into investments, and also their contribution to increase the capital stock is limited. The reason for this can be explained as the negative climate for investments in the country due to high costs and high interest rates, which will be discussed in following sections while examining crowding out. However, the answer to this lies in the above mentioned measures that need to be taken at once. Due to negative climate for investments in the country, the under-taxed or not taxed revenues are not channelled to investments, they outflow creating a negative effect on capital stock in the country.

In the light of the statistics, budget revenues have not been increased to the desired level in an efficient way. At this stage, it is obvious that the revenue side of fiscal policies have not been effective enough. At this stage, improving the VAT application and allowing funds to flow to the budget, as revenue might be a short run measure for changing the structure of local revenues.

2.3 Foreign Aid and Loans, the Budget Deficit

When the revenues of the budget do not counterbalance the expenditures, it is said that there is a budget deficit. When budget deficits occur, governments should find ways and methods for financing the deficits. As it can be seen from Tables 3.1, 3.2, 3.3 and from sections 2.1 and 2.2 of this chapter, budget expenditures exceed the budget revenues in the case of the TRNC. The shares of total budget expenditures and total budget revenues in GNP are listed in Table-3.6 for the period 1977-1997. Also, composition of budget expenditures and revenues can be seen in Graphs 3.1a and 3.1b.

In this section, the historical development of the budget deficits in the TRNC, the methods of deficit financing in theory briefly, and the way the deficits are

BUDGET DEFICIT PROBLEM AND ITS IMPACT ON THE TRNC ECONOMY

ENGİN ARI

EASTERN MEDITERRANEAN UNIVERSITY
1999

EASTERN MEDITERRANEAN UNIVERSITY
INSTITUTE OF RESEARCH AND GRADUATE STUDIES

BUDGET DEFICIT PROBLEM AND ITS IMPACT ON THE TRNC ECONOMY

A MASTER'S THESIS
BY
ENGİN ARI
FOR THE DEGREE OF MASTER OF SCIENCE
IN
ECONOMICS

GAZIMAĞUSA September, 1999

BUDGET DEFICIT PROBLEM
AND ITS IMPACT
ON THE
TRNC
ECONOMY

by

Engin ARI

September, 1999

Dissertation submitted to Eastern Mediterranean University in partial fulfillment of the requirements for the degree of Master of Science in Economics

EASTERN MEDITERRANEAN UNIVERSITY
FACULTY OF BUSINESS AND ECONOMICS

Thesis Title : Budget Deficit Problem and Its Impact on the TRNC Economy.

Submitted by : Engin ARI

Department : Economics

Approval of the Institute of Research and Graduate Studies.

Assoc. Prof. Dr. Zeka MAZHAR
(Head of the Institute)

I certify that this thesis satisfies all the requirements as a thesis for the degree of Master of Science.

Prof. Dr. Ahmet YÖRÜKOĞLU
(Head of Economics Department)

Thesis Examining Committee

Prof. Dr. Ahmet YÖRÜKOĞLU
(Supervisor)

Assist. Prof. Dr. Danbala DANJU

Assist. Prof. Dr. Abdul GHAFOOR

Acknowledgements

I would like to express my deep gratitude to Prof. Dr. Ahmet Yörükoğlu for his self-sacrificing supervision and encouragement throughout this study. I also would like to thank Dr. Hasan A. Bıçak for his support. I am grateful to Mr. Ahmet Z. Bulunç for his continuous motivation as well as for his intellectual help. My sincere thanks are due to Mr. Birol Betoncu, Mr. Cevdet Başaran, Ms. Fatma Kınış and Ms. Hayriye Sonuvar. Their help in editing the final draft added a lot to the comprehensive value of the thesis. My special thanks are also to my wife Refia Arı and to my sons Anıl and Orhan for their patience and understanding in helping me to accomplish this work. Without their help, this work could not have been done.

Abstract

The Turkish Republic of Northern Cyprus is experiencing socio-economic structural problems that have been accumulated throughout the years since its establishment. The structural problems have led to the budget deficits that create a big burden on an economy. For, a budget is not only a legal document which specifies the public expenditures, revenues and public needs, but it is also an important instrument in the realisation of planned growth and socio-economic structure in a country.

The aim of this study is to investigate the effects of budget deficits on the economy of Turkish Republic of Northern Cyprus. Factors creating the budget deficits and the methods used in financing these deficits in Turkish Republic of Northern Cyprus have been discussed in detail.

In this study, public finance of Turkish Republic of Northern Cyprus in general and the budget deficit in particular, have been evaluated. The structures of the budget and the public sector have been analysed in a time perspective and the main problems concerning public finance of the country are identified.

The effects of financing the budget deficits on the economy and the methods used in financing the deficits have been investigated from different aspects, using various methods. Theoretical concepts about financing the budget deficits and about the effects that they create on an economy have been introduced and compared with the case in Turkish Republic of Northern Cyprus.

Within the frame of this study, some policy solutions for minimizing the negative effects of budget deficits on the economy have been suggested in brief.

Abstract

Kuzey Kıbrıs Türk Cumhuriyeti kuruluşundan bu yana yıllarca biriken yapısal sosyo-ekonomik sorunlar yaşamaktadır. Bu yapısal sorunlar, ekonomi üzerinde büyük bir yük oluşturan bütçe açıklarına neden olmuşlardır. Çünkü bütçe, yalnızca kamu gelir ve giderleri ile kamusal ihtiyaçları belirleyen bir yasal doküman değil, aynı zamanda, bir ülkede planlı büyüme ve sosyo-ekonomik yapının gerçekleştirilmesinde de önemli bir araçtır.

Bu çalışmanın amacı, Kuzey Kıbrıs Türk Cumhuriyeti ekonomisi üzerinde bütçe açıklarının etkilerini araştırmaktır. Kuzey Kıbrıs Türk Cumhuriyeti'nde bütçe açıklarını yaratan nedenler ve bu açıkların finansmanında kullanılan yöntemler detaylı olarak tartışılmıştır.

Bu çalışmada, genel olarak Kuzey Kıbrıs Türk Cumhuriyeti'nin kamu maliyesi ve detaylı olarak da bütçesi değerlendirilmiştir. Bütçe ve kamu sektörünün yapıları analiz edilerek ülkenin kamu maliyesinde yaşanan sorunlar bir zaman perspektifi içerisinde tanımlanmıştır.

Bütçe açıklarının finansmanının ekonomi üzerindeki etkileri ve açıkların finansmanında kullanılan yöntemler farklı yönlerden ve değişik yöntemler kullanılarak araştırılmıştır. Bütçe açıklarının finansmanı ve ekonomi üzerinde yarattıkları etkilerle ilgili teorik kavramlara değinilmiş ve Kuzey Kıbrıs Türk Cumhuriyeti'ndeki durumla karşılaştırma yapılmıştır.

Bu çalışma çerçevesinde, bütçe açıklarının ekonomi üzerindeki olumsuz etkilerini asgari seviyeye indirmek için kısa olarak bazı politika önerileri yapılmıştır.

TABLE OF CONTENTS

LIST OF TABLES , FIGURES AND GRAPHS

Preface

In recent years there have been a lot of discussions about budget deficits. Many economists and other observers have viewed these deficits as harmful to countries' economic positions. These harmful effects include high real interest rate, low savings, and low rates of economic growth and crowding out of private sector from the investments. In this context the financing methods of budget deficits are very important aspect of economic activities as well.

The Turkish Republic of Northern Cyprus has also had a serious budget deficit problem since 1977. The structural problems, especially the high share of public sector in the economy and the consequent low level of productivity, have led to the budget deficits in the country Current expenditures, especially the personnel expenditures and transfer payments, are the main elements that create budget deficits. Losses of the Public Economic Enterprises are other problems that cause budget deficits.

The usual way of financing budget deficits is either to engage in domestic borrowing via issuance of bonds and bills or the use of money financing method. The use of short-term advances from the Central Bank is another way of domestic borrowing. Issuance of bonds and bills has not been applicable to the Turkish Republic of Northern Cyprus since the financial market is not well developed. The use of money financing method, in other words, creating new money (printing money) is not applicable either since the Turkish Lira is in circulation as legal tender. Therefore, she does not have too many alternatives for financing its deficits. Aids and borrowing from Turkey finance large portion of her budget deficits, which have never been paid back. Some domestic borrowing is done through the Central Bank as short-term advances lent to the Treasury Department of the state. The size of domestic Treasury borrowing has changed significantly since the establishment of the Central Bank.

The aim of this study is to investigate the effects of budget deficits, on the economy of the Turkish Republic of Northern Cyprus. Another aim of the study is to suggest brief policy solutions for minimizing the negative effects of budget deficits on the economy of the country.

In Chapter I, three schools of thought concerning the economic effects of budget deficits are discussed; Neo-classical, Ricardian and Keynesian. The basic structure and implications of each paradigm is summarized under financing the budget deficits by debt instead of tax financing.

In Chapter II, public sector deficit and the ways of financing this deficit is analysed in a time perspective for the period 1982-1997. Also, fiscal policy tools that are employed in the Turkish Republic of Northern Cyprus are examined in this chapter.

In Chapter III, the budget of the country has been analysed in a time perspective for the period 1977-1997. As a result of this analysis, the causes of budget deficits are identified and the financing methods adopted in the country are examined with reference to the period 1977-1997.

In Chapter IV, effects of budget deficits on the economy of the country are discussed in detail. Interest rates, balance of investments and savings, developments in fixed capital investments and the distribution of advances and rediscounts from the Central Bank's resources together with the sectoral distribution of advances, loans and bills discounted from the whole banking system are analysed in a time perspective.

In Chapter V, conclusion of the study is drawn and policy solutions for minimizing the negative effects of budget deficits on the economy of the Turkish Republic of Northern Cyprus are suggested in brief.

I. THEORETICAL APPROACHES

1. Introduction

Traditional public finance theory mainly covers taxes, public expenditures and public debt. Taxes being weightier; borrowing is the main alternative to taxes for financing the budget deficits. Too many discussions have been made about public debt and deficit financing for years. The three theoretical approaches about the subject are generally considered while discussing the economic effects of the budget deficits. These approaches are the Neo-classical approach, the Keynesian approach and the Ricardian approach.

2. Standard Neo-classical Model

The neo-classical approach to fiscal policy emphasises the microeconomic linkages among government spending, debt and tax policies and their effects on households and firms. It asserts that the scope for active fiscal policy is radically less than what the Keynesian approach suggests.[1]

The neo-classical approach focuses on households, permanent income and ability to spend. If an individual's taxes are cut now, and if the same person has to pay off the interest and principal on the debt floated to finance the tax cut, the person's permanent income does not changed. In this example, there is no reason, on permanent income grounds; to think that a tax cut will increase the person's spending.

At the aggregate level, suppose everyone believed that the national debt would eventually be paid off. At some point in the future, the government would have to run a surplus to pay off the debt. That means it would have to raise taxes in the future. Therefore, an increase in the debt would increase individuals' wealth and at the same time suggest to them that their taxes

[1] Dornbush and Fischer, **MACROECONOMICS**, 6. Ed, McGrawhill, Singapore, 1994. p.587

would be higher in the future. The net effect on aggregate demand might then be zero.[2]

The neo-classical model of the debt stresses that when the government initiates a project, whether financed by taxes or borrowing, resources are removed from the private sector.[3] One usually assumes that when tax finance is used, most of the resources removed come at the expense of consumption. On the other hand, when government borrows, it competes for funds with individuals and firms who want the money for their own investment projects. Hence it is generally assumed that debt has most of its effect on private investment. To the extent that these assumptions are correct, debt finance leaves future generations with a smaller capital stock, ceteris paribus. Its members therefore are less productive and have smaller real incomes than otherwise would have been the case.

The assumption that government borrowing reduces private investment plays a key role in the neo-classical analysis. It is sometimes referred to as the *crowding out* hypothesis- when the public sector draws on the pool of resources available for investment, private investment is crowded out. Crowding out is induced by changes in the interest rate. When the government increases its demand for credit the interest rate, which is just the price for credit, must go up. But if the interest rate goes up, private investment becomes expensive and less of it is undertaken.[4] Unfortunately, things are complicated by the fact that other variables can also probably affect interest rates. For example, during a recession, investment decreases and hence the interest rate falls. At the same time, slack business conditions lead to smaller tax-collections, which increase the deficit, Ceteris paribus.

---

[2] Ibid., p. 588.
[3] Harvey S. Rosen, **PUBLIC FINANCE**, 4. Ed, IRWIN, USA, 1995. p. 467.
[4] Ibid., p. 467.

Hence, the data may show an inverse relationship between the interest rate and deficits, although this says nothing one way or the other about crowding out. As usual, the problem is to sort out the independent effect of deficits on interest rates, and this kind of problem can be quite difficult. According to Harvey S. Rosen, author of *Public Finance*, when Miller and Roberds [1992] reviewed the econometric studies of this issue, they found conflicting results. Despite the murkiness of the econometric evidence, the theoretical case for at least same crowding out is so strong that most economists agree that large deficits cause same reduction in the capital stock. However, the precise size of this reduction, and hence the reduction in welfare for future generations, is not known.

3. Ricardian Equivalence Theorem

Harvey S. Rosen, in his book *Public Finance,* wrote that Barro [1974] has argued that " when the government borrows, members of old generation realize that their heirs will be made worse off ". Suppose further that, the old care about the welfare of their descendants and therefore do not want their descendants' consumption levels reduced. What can the olds do about this? One possibility is simply to increase their bequests by an amount sufficient to pay the extra taxes that will be due in the future. The result is that nothing really changes. Each generation has exactly the same amount of consumption that it had before the government borrowed.

In effect, then, private individuals can undo the intergenerational effects of government debt policy so that tax and debt finance is essentially equivalent. This view that the form of government finance is irrelevant, is often referred to as Ricardian Model because, its antecedents appeared in the work of the 19th century British economist David Ricardo.

According to Harvey S. Rosen, author of the book *Public Finance*, Barro 's provocative hypothesis on the irrelevance of government fiscal policy has been the subject of many debates. Some reject the idea as being based on an

incredible assumption. Information on the implications of current deficits on future tax burdens is not easy to obtain; indeed, it isn't even clear how big the debt is! Harvey S. Rosen, in his book *Public Finance*, mentions about another criticism by Bernheim and Bagwell [1988] which argues that, " through marriage, virtually all people end up related to one another ". The model implies that the nation acts as one big happy family, busily undoing all government policy.

On the other hand, it could be argued that the ultimate test of the theory is not the plausibility of its assumptions, but whether or not it leads to the predictions that are confirmed by the data. Harvey S. Rosen in his book *Public Finance* states that, Gramlich [1989] noted that in early 1980's, there was a huge increase in federal deficits. If the Ricardian model were correct, one would have expected private savings to increase commensurately. At the same time the federal deficit increased, however, private savings (relative to net national product) actually fell. While this finding is suggestive, it is not conclusive because factors other than the deficit affect the saving rate. Harvey S. Rosen, author of the book *Public Finance,* mentions that Bernheim [1990] carried out a number of econometric studies and analysed the relationship between budget deficits and saving. Although the evidence is mixed, the general finding is that even after taking other variables into account, saving does not increase enough to offset increased deficits. There seems to be mounting evidence that although some intergenerational altruism doubtless exists, its presence does not render debt policy irrelevant.[5]

As it is mentioned while explaining the neo-classical view, in neo-classical model an increase in the debt would increase individuals ' wealth. Then the question "Are government bonds wealth?" is raised. According to Barro-Ricardo equivalence proposition that states that the debt financing by bond issue merely postpones taxation and in many instances it is strictly

[5] Ibid., p. 469.

equivalent to current taxation, bonds are not net wealth.[6] People realize that their bonds will have to be paid off with future increases in the budget deficit unaccompanied by savings that precisely match the deficit.

There are two main theoretical objections to the Barro-Ricardo approaches. First, given that people have finite lifetimes, the people who are receiving the tax cut today, will not be paying off the debt tomorrow. This argument assumes that people now alive do not take into account the higher taxes their descendants will have to pay in the future. Second, it is argued that many people cannot borrow, and thus do not consume according to their permanent income. They would like to consume more today but because of the liquidity constraints -their inability to borrow- they are constrained to consuming less than they would want according to their permanent income. A tax cut for these people eases their liquidity constraint and allows them to consume more.

These theoretical disagreements mean that the Barro - Ricardo hypothesis has to be settled by examining the empirical evidence. The evidence to date is on balance unfavourable to the Barro - Ricardo approach but recognises that the issue has not yet been decisively settled.

4. Keynesian Approach

Traditional Keynesian approach is separated from the neo-classical approach in two fundamental points. First one is the assumption that some economic resources are not fully employed in an economy. And the second one is the assumption that the individuals are short sighted in their decisions concerning the future. This second assumption leads to the result that aggregate demand is very sensitive to the changes in disposable income. According to this, in simple Keynesian model, since individuals will tend to consume their disposable income, a cut in personal taxes will create a sudden and important effect on aggregate demand and aggregate demand

[6] Dornbush and Fischer, op.cit., p.588.

will tend to increase. Unless there is full employment, national income will increase by the effect of known Keynesian multiplier (Figure-1.1). Thus there will not be any negative effect on saving and capital accumulation since budget deficits encouraged consumption and national income. Moreover, if households treat the debt with which the deficit is financed as a net worth, there may be further demand for expansion as a result of debt financing. This line of thinking has been sharply attacked and rejected by the neo-classical approach to fiscal policy.[7] The effects of fiscal policy in Keynesian model, can be seen in Figure-1.1 by analysing the IS and LM curves, assuming that there has been an increase in government spending.

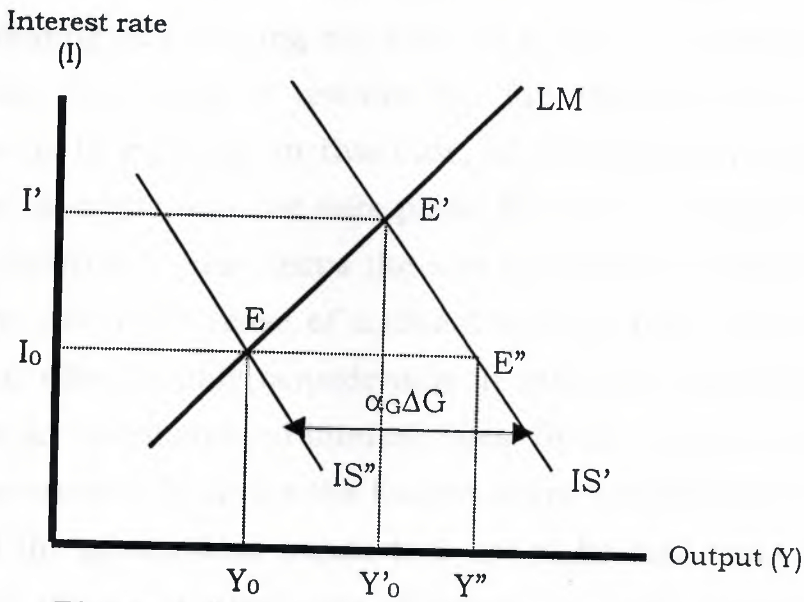


Figure-1.1 Increase in Government Spending

In the standard IS-LM analysis, this increase in national income will increase the demand for money.[8] If the money supply is fixed- meaning that borrowing from individuals and firms finances budget deficit - interest rates will increase and private investments will decrease by the crowding out effect. This means a decline in national income and balancing of the Keynesian multiplier effect due to the crowding out effect.

[7] Ibid., p. 587.
[8] Prof.Dr. Şevki ÖZBİLEN, **MALİYE POLİTİKASI**, Ezgi Kitabevi, 1998 Bursa, p.274

Many Keynesian economists support the view that no crowding out effect will be created on private investments due to budget deficits.[9] Because, the aggregate demand that is increased due to budget deficits will increase the profitability of the private investments and will lead to a higher investment level at a specific interest rate. In this case, in spite of the fact that budget deficit cause increases in the interest rates, it can encourage aggregate saving and investments. In other words, if there is not full employment in an economy, important budget deficits will influence the consumption due to the increased demand, as long as a negative monetary policy is not implemented. And as a result of increased profitability of investments due to the increased consumption, there will be a positive effect on investments creating no crowding out effect in spite of the increase in interest rates. But after the economy reaches the full employment level, general price level tends to increase. In this case, an increase in consumption or a decline in investments may not take place. Because, as long as the inflation tax at full employment case keeps the rate of increase of budget deficits equated with the rate of increase of national income, only inflation increases. Crowding out effect is only considerable in the case where there is a tight monetary policy and increased interest rates. But it is important that in the case where government finances the budget deficits by domestic borrowing, interest rate of the government bonds that are to be sold must be more attractive than the market interest rate. Since in this case interest rates will have to be increased, crowding out effect will be generated. As a result, the negative effect of budget deficits on the capital stock is only possible at the full employment level.[10]

[9] Ibid., p. 274.
[10] Dornbush and Fischer, op.cit., p.13.

II. FISCAL POLICY AND THE GENERAL BALANCE OF PUBLIC SECTOR IN THE TRNC

1. Introduction

Fiscal policy is a branch of general economic policy. When the tools used for achieving the economic policies are related to public economics, the intervention done is defined as the fiscal policy. Importance of public finance is increasing in the TRNC, due to the social and economic developments.

For achieving the macro economic targets, the state of TRNC has to implement its tax and public expenditure programs in harmony with the fiscal policy.

General Balance of public sector shows what proportion of the goods and services created is used by the public sector, how much of this proportion is consumed, how much is transferred to investments, what amount is saved and what is the need for finance if there are any. With these properties, general balance of public sector determines the revenues-expenditures balance and the need for additional finance.

In this chapter, the fiscal policy targets in the TRNC and the fiscal policy tools that are used to achieve the targets will be analysed. The elements of general balance of public sector will be listed and the period of 1982-1997 will be examined. By this way the evolution of public revenues and public expenditures will be displayed and public deficits together with the investments and savings of the public sector will be evaluated within the specified period. At the end of the chapter the result will be commented on together with the conclusions.

It will be noticed that, the period under consideration for the general balance of public sector (will be examined in this chapter) begins at the year 1982, while the period under consideration for the balance of state budget (will be

examined in the next chapter) begins at the year 1977. The reason for this is; data for the general balance of public sector was not collected by the State Planning Organization until the year 1982 and the data for the balance of state budget is used for this purpose until that time. Thus, the only available data that can be used for the analysis of general balance of public sector is the data of the period 1982-1997 (Tables 2.1, 2.2).

2. Fiscal Policy and Fiscal Policy Tools in the TRNC

The state, within the fiscal policy, uses three important tools for achieving stabilization and economic development, for maintaining and providing the economic equilibrium, for increasing the life standard and for establishing a more regular distribution of income and wealth. These tools are public expenditures, taxes and borrowings.[11] Three of these are the fiscal policy tools used in the TRNC.

In the TRNC, fiscal policy tools are employed in order to increase the savings and transfer them to productive fields of investments and attract foreign investors to the country.[12]

Fiscal policies in the TRNC are intended to be carried out in the direction of reducing the public current expenditures, increasing the infrastructure investments, and encouraging the private sector investments by use of selective tools. It is intended to attach more importance to tax exemption policies for investment tools and production inputs and to remove completely, the tax burden from the shoulders of production and investment.[13]

---

[11] Orhaner EMİNE, **KAMU MALİYESİ**, Gazi Kitabevi, 1997 Ankara, p.257.

[12] KKTC Başbakanlık, DPÖ, **ÜÇÜNCÜ BEŞ YILLIK KALKINMA PLANI 1993-1997 STRATEJİSİ, AMAÇLARI, MAKRO HEDEF VE DENGELERİ**, 1992 Lefkoşa, p.21.

[13] KKTC Başbakanlık, DPÖ, **1999 GEÇİŞ YILI PROGRAMI**, 1999 Lefkoşa, p.74.

3. General Balance of Public Sector

3.1 Public Revenues

In spite of the fact that private saving is voluntary, public revenues are considered to be inevitable sources in the creation of capital sources for the economy. Because of this, it is one of the priorities of the states to improve public revenues for the formation of the country's capital sources and for speedily increasing them.

In the TRNC, importance is attached to increase of public revenues for the improvement of capital sources and for the activation of the public services. Public revenues in the TRNC are composed of three main elements, which are:

i- Tax revenues
ii- Income other than Taxes
iii- Factor and Fund revenues.

Within the context of this study, Public Revenues are sometimes referred to as "Total Public Revenues" in order to imply that they are composed of the sum of the three elements mentioned above.

3.1.1 Tax Revenues

Tax revenues are made up of direct and indirect taxes.

i) Direct Taxes:

- Income tax
- Vehicle and driving licenses
- Institutions tax
- Property tax
- Inheritance tax.

ii) Indirect Taxes:

- Customs tax
- Bank and insurance tax
- Value Added Tax.[14]

3.1.2 Income Other Than Taxes

Public revenues include some revenues, which can not be classified as taxes. These are:

i- Revenues which can not be classified as Taxes:

a) Fees:

- Court fees
- Fees for company and partners registration;
- Property registration fees
- Import and export certificate fees
- Identity registration fees
- Passport fees
- Other fees

b) Revenues of Services Provided:

- Telephone-telegrams and telex charges
- Postal charges
- Theatre, sports and cultural activities charges
- Travelling fees
- Overtime pays of customs and port
- Warehouse rents
- Port and boats charges
- Fines and confiscation.

[14] Ekonomi ve Maliye Bakanlığı, KKTC 1995 **MALİ YILI BÜTÇE TASARISI**, 1994, pp.31-34.

ii- Revenues of Public Enterprises:

These are mainly the revenues from:

- Cypruvex Public Enterprises,
- State Breeding Farm;
- Institution of Electricity Supplies.

iii- Treasury Property Rents.

iv- Various revenues

- Revenues from state publications;
- Contributions of state personnel (by retirement law)
- Sales of telephone directory.

3.1.3 Factor and Fund Revenues

The law passed in 1992 and the statutes applied in 1993, have allowed the public to use funds as revenues, starting from 1994's budget. Hence 50 % of:

- Foreign exchange stability fund,
- Price stability fund, and
- 10% of Tourism encouragement fund

(To be transferred to state budget), are used as revenues.

3.1.3.1 Types of Fund Revenues Used

i-Foreign Exchange Stability Fund

These are the fund revenues of the state from differences in the rate of exchange. They are obtained from the exports of goods. The main aim of this fund is to be able to meet the negative effects in case of unexpected shocks in financial markets.

ii- Price Stability Fund

They are the charges imposed on products the use or import of which are sought to be discouraged such as cigarette, alcohol etc. Besides others, it also laid on petrol prices. According to some economists this fund is introduced for contributing to the construction and management of the electricity plant in Teknecik.

iii- Tourism Encouragement Fund

These funds are generated from the travellers at the customs. It is a kind of tax imposed on foreigners. The aim of this fund is to contribute to the promotion and infrastructure of tourism.

On one hand, it seems economically logical to have such funds, as they will be used for improving the infrastructure, for the protection of producers and for the promotion of tourism. But on the other hand, it is well known that these funds are not used for fulfilling the objectives they are implemented for, but are used for financing the public current expenditures and the deficits.

Public revenues have increased from 6,097.5 Million TL in 1982 to 41,249,297.0 Million TL in 1997 at current prices. At 1977 constant prices, public revenues increased from 780.2 Million TL in 1982 to 2,779.5 Million TL in 1997 (Tables-2.1, 2.2). The increase in public revenues in this period (1982-1997) has been 256.3% in total. The yearly average rise in this period has realized as 8.5%.[15] The share of public revenues in GNP has increased from 17.9% in 1982 to 34.9% in 1997. This result shows that there has been a total increase of 95.0% in the share of revenues in GNP within the period. This increase in share of public revenues in GNP amounts to a yearly average rise of 4.5%. The average share of the revenues in GDP for the period has been realized as 31.2% (Table-2.4).

[15] Yearly average rise is calculated by using the compound rate of growth formula $P_t = P_0 . e^{rt}$. For further detail see Damodar Gujarati, **ESSENTIALS OF ECONOMETRICS**, McGraw-Hill, 1992 U.S.A, p.232.

Table-2.1GENERAL BALANCE OF PUBLIC SECTOR

(Current Prices, Million TL)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
I. Public Revenues	6,097.5	12,236.2	20,049.1	32,192.9	49,179.7	94,146.8	178,942.2	286,859.4	573,648.1	855,055.7	1,263,950.8	2,401,999.9	6,229,157.8	10,753,633.8	20,673,365.5	41,249,297.0
1. Taxes	3,489.1	6,723.1	10,578.7	17,580.0	26,329.5	48,246.9	90,713.0	162,989.3	331,717.8	430,621.2	737,868.2	1,408,500.4	3,160,404.8	6,300,178.6	11,647,287.6	25,743,868.1
a) Direct Taxes	1,515.0	2,895.1	5,004.5	8,592.0	14,496.3	26,227.4	47,205.7	84,424.3	166,109.9	248,397.8	401,781.5	743,923.0	1,813,865.8	3,672,222.2	6,595,689.4	14,334,207.8
b) Indirect Taxes	1,974.1	3,828.0	5,574.2	8,988.0	11,833.2	22,019.5	43,507.3	78,565.0	165,607.9	182,223.4	336,086.7	664,577.4	1,346,539.0	2,627,956.4	5,051,598.2	11,409,660.3
2. Income Other Than Taxes	1,070.0	1,915.7	2,580.4	3,916.0	6,951.5	10,764.0	18,470.3	32,759.4	58,611.3	107,806.5	175,422.2	338,361.2	855,053.7	1,982,078.5	3,630,912.5	7,513,055.1
3. Income From Factors and Funds	1,538.4	3,597.4	6,890.0	10,696.9	15,898.7	35,135.9	69,758.9	91,110.7	183,319.0	316,628.0	350,660.4	655,138.3	2,213,699.3	2,471,376.7	5,395,165.4	7,992,373.8
II. Transfers	2,899.0	4,801.1	7,935.7	15,534.8	25,529.7	37,962.5	51,551.6	77,122.9	167,717.1	303,023.7	468,764.1	874,006.4	2,282,638.7	5,787,485.4	9,815,806.1	19,318,478.3
III. Public Disposable Expenditures	3,198.5	7,435.1	12,113.4	16,658.1	23,650.0	56,184.3	127,390.6	209,736.5	405,931.0	552,032.0	795,186.7	1,527,993.5	3,946,519.1	4,966,148.4	10,857,559.4	21,930,818.7
IV. Public Current Expenditures	7,722.0	9,451.3	16,157.9	26,372.4	41,136.1	59,710.8	95,975.7	169,992.7	350,359.4	591,644.5	909,361.0	1,523,275.7	3,944,913.8	8,078,733.9	14,228,783.4	29,112,466.5
V. Public Savings	-4,523.5	-2,016.2	-4,044.5	-9,714.3	-17,486.1	-3,526.5	31,414.9	39,743.8	55,571.6	-39,612.5	-114,174.3	4,717.8	1,605.3	-3,112,585.5	-3,371,224.0	-7,181,647.8
VI. Public Investments	1,679.8	3,766.8	6,065.7	8,365.4	12,583.5	23,032.1	21,653.1	42,734.5	102,328.4	93,532.3	213,758.2	452,475.2	813,533.6	1,275,418.4	4,160,245.5	7,410,813.1
1. Fixed Capital	1,745.8	3,203.7	5,095.6	7,626.4	10,913.9	21,707.2	17,462.8	38,015.4	91,938.0	84,132.2	157,994.1	407,014.0	780,605.1	1,152,616.9	3,786,884.0	6,555,971.6
2. Changes in Stocks	-66.0	563.1	970.1	739.0	1,669.6	1,324.9	4,190.3	4,719.1	10,390.4	9,400.1	55,764.1	45,461.2	32,928.5	122,801.5	373,361.5	854,841.5
VII. Public Deficit	6,203.3	5,783.0	10,110.2	18,079.7	30,069.6	26,558.6	-9,761.8	2,990.7	46,756.8	133,144.8	327,932.5	447,757.4	811,928.3	4,388,003.9	7,531,469.5	14,592,460.9

Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-14, 1998 Lefkoşa, pp.22,23.

Table-2.2 GENERAL BALANCE OF PUBLIC SECTOR

(1977 Prices, Million TL)

		1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
I.	Public Revenues	780.2	1,155.0	1,281.3	1,289.1	1,342.0	1,851.0	2,240.8	2,081.3	2,586.0	2,484.4	2,230.3	2,611.8	2,730.5	2,279.7	2,495.2	2,779.5
	1. Taxes	446.5	634.6	676.1	704.0	718.3	948.6	1,135.9	1,182.6	1,495.4	1,251.2	1,302.0	1,531.5	1,385.3	1,335.6	1,405.8	1,734.6
	a) Direct Taxes	193.9	273.3	319.9	344.1	395.5	515.7	591.1	612.6	748.8	721.7	709.0	808.9	795.1	778.5	796.1	965.8
	b) Indirect Taxes	252.6	361.3	356.2	359.9	322.8	432.9	544.8	570.0	746.6	529.5	593.0	722.6	590.2	557.1	609.7	768.8
	2. Income Other Than Taxes	136.9	180.8	164.9	156.8	189.7	211.6	231.3	237.7	264.2	313.2	309.5	367.9	374.8	420.2	438.2	506.3
	3. Income From Factors and Funds	196.8	339.6	440.3	428.3	434.0	690.8	873.6	661.0	826.4	920.0	618.8	712.4	970.4	523.9	651.2	538.5
II.	Transfers	370.9	453.1	507.2	622.1	696.7	746.4	645.6	559.6	756.7	880.4	827.2	950.4	1,000.6	1,226.9	1,184.7	1,301.7
III.	Public Disposable Expenditures	409.3	701.9	774.1	667.0	645.3	1,104.6	1,595.2	1,521.7	1,829.9	1,604.0	1,403.1	1,661.4	1,729.9	1,052.8	1,310.5	1,477.7
IV.	Public Current Expenditures	988.1	892.2	1,032.6	1,056.0	1,122.3	1,174.0	1,201.8	1,233.4	1,579.4	1,719.1	1,604.6	1,656.3	1,729.2	1,712.7	1,717.2	1,961.6
V.	Public Savings	-578.8	-190.3	-258.5	-389.0	-477.0	-69.4	393.4	288.3	250.5	-115.1	-201.5	5.1	0.7	-659.9	-406.7	-483.9
VI.	Public Investments	215.0	355.5	387.6	335.0	343.4	452.8	271.2	310.0	461.3	271.8	377.2	492.0	356.6	270.3	502.2	499.3
	1. Fixed Capital	223.4	302.4	325.6	305.4	297.8	426.8	218.7	275.8	414.5	244.5	278.8	442.6	342.2	244.3	457.1	441.7
	2. Changes in Stocks	-8.4	53.1	62.0	29.6	45.6	26.0	52.5	34.2	46.8	27.3	98.4	49.4	14.4	26.0	45.1	57.6
VII.	Public Deficit	793.8	545.8	646.1	724.0	820.4	522.2	-122.2	21.7	210.8	386.9	578.7	486.9	355.9	930.2	908.9	983.2

Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler,Table-15, 1998 Lefkoşa, p.24.

Table-2.3 Public Revenues							(At 1977 prices, Million TL)
Years	**Taxes**	**%**	**Income Other Than Taxes**	**%**	**Factor and Fund Revenues**	**%**	**Total Public Revenues**
1982	446.5	57.2	136.9	17.6	196.8	25.2	780.2
1983	634.6	54.9	180.8	15.7	339.6	29.4	1,155.0
1984	676.1	52.8	164.9	12.9	440.3	34.4	1,281.3
1985	740.0	57.4	156.8	12.2	428.3	33.2	1,289.1
1986	718.3	53.5	189.7	14.1	434.0	32.3	1,342.0
1987	948.6	51.3	211.6	11.4	690.8	37.3	1,851.0
1988	1,135.9	50.7	231.3	10.3	873.6	39.0	2,240.8
1989	1,182.6	56.8	237.7	11.4	661.0	31.8	2,081.3
1990	1,495.4	57.8	264.2	10.2	826.4	32.0	2,586.0
1991	1,251.2	50.4	313.2	12.6	920.0	37.0	2,484.4
1992	1,302.0	58.4	309.5	13.9	618.8	27.8	2,230.3
1993	1,531.5	58.6	367.9	14.1	712.4	27.3	2,611.8
1994	1,385.3	50.7	374.8	13.7	970.4	35.5	2,730.5
1995	1,335.6	58.6	420.2	18.4	523.9	23.0	2,279.7
1996	1,405.8	56.3	438.2	17.6	651.2	26.1	2,495.2
1997	1,734.6	62.4	506.3	18.2	538.5	19.4	2,779.5

--Shares are calculated by using the statistics of the SPO
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, 1998 Lefkoşa, Table-15, p.24.

Tax revenues have increased from 446.5 Million TL in 1982 to 1,734.6 Million TL in 1997 at 1977 constant prices. This result amounts to a rise of 288.5% in total and 9.1% yearly average for the period (Table-2.2). The average share of tax revenues in total public revenues has been 55.6% in the period 1982-1997 (Table-2.2). The ratio of tax revenues to GNP increased from 10.2% in 1982 to 21.8% in 1997. This result shows a total increase of 113.7% in the ratio of tax revenues to GNP within the period. The average yearly rise of this ratio has been 5.2%. The average ratio of tax revenues to GNP for the period has been 17.3% (Table-2.4).

Income other than taxes has increased from 136.9 Million TL in 1982, to 506.3 Million TL in 1997 at 1977 constant prices. This result shows an increase of 269.8% in total and a 8.7% average yearly rise within the period (Table-2.2). The period's average share of income other than taxes in total public revenues has been 14.0% (Table-2.3). The ratio of income other than taxes to GNP has increased from 3.1% in 1982 to 6.4% in 1997. This result has shown a total of 106.5% increase in this ratio within the period. The average yearly increase in the ratio of income other than taxes to GNP has been 5.2%. Period's average for this ratio has been realized as 4.3% (Table-2.4).

Factor and fund revenues have increased from 196.8 Million TL in 1982 to 538.5 Million TL in 1997 at 1977 constant prices. This result shows an increase of 173.6% in total and a rise of yearly average 6.7% in real terms within the period (Table-2.2). The period's average share of factor and fund revenues in total public revenues has been 30.7% (Table-2.3). The ratio of factor and fund revenues to GNP has increased from 4.5% in 1982 to 6.8% in1997. This result amounts to a total increase of 51.1% in the ratio of factor and fund revenues to GNP, and a yearly average rise of 2.8% in this ratio, for the period. The average ratio of factor and fund revenues to GNP has been 9.6% for the period [Table-2.4).

The decline in the share of factor and fund revenues in total public revenues in 1997 is noticeable (Table-2.3). This is mainly due to the continuous high losses of Cypruvex Public Enterprises Company.[16] The increase in tax revenues due to the VAT and Property tax applications has also played a role in the decline in the share of factor and fund revenues.[17] On the other hand, the highest increase in the share of total public revenues within the period 1982-1991 has been realized in factor and fund revenues with an increase of 13.8% in 1988 (Table-2.3). This was because of the increase in social security funds.[18]

It is obvious that the highest share in public revenues is the share of tax revenues within the period 1982-1997, reaching the highest share with 62.41% in 1997. This shows that taxes form the main source of public revenues. Therefore, in the TRNC, state uses the taxes as the main fiscal policy tool for increasing its revenues.

Composition of Public Revenues can be seen in Graph-2.1a.

[16] KKTC Başbakanlık, **DPÖ, 1998 GEÇİŞ YILI PROGRAMI**, Lefkoşa 1997, p.39.
[17] Ibid., p.39.
[18] İktisadi Araştırmalar Vakfı, **KKTC EKONOMİSİNİN YENİDEN YAPILANMASI**, İstanbul 1993, p.47.

Table-2.4 Public Revenues – Ratios to GNP - (At 1977 prices, Million TL)									
Years	GNP	Taxes	% GNP	Income Other Than Taxes	% GNP	Factor and Fund Revenues	% GNP	Total Public Revenues	% GNP
1982	4,369.5	446.5	10.2	136.9	3.1	196.8	4.5	780.2	17.9
1983	4,440.4	634.6	14.3	180.8	4.1	339.6	7.7	1,155.0	26.0
1984	4,725.2	676.1	14.3	164.9	3.5	440.3	9.3	1,281.3	27.1
1985	5,080.4	740.0	14.6	156.8	3.1	428.3	8.4	1,289.1	25.4
1986	5,324.1	718.3	13.5	189.7	3.6	434.0	8.2	1,342.0	25.2
1987	5,684.1	948.6	16.7	211.6	3.7	690.8	12.2	1,851.0	32.6
1988	6,084.0	1,135.9	18.7	231.3	3.8	873.6	14.4	2,240.8	36.8
1989	6,603.0	1,182.6	17.9	237.7	3.6	661.0	10.0	2,081.3	31.5
1990	6,977.4	1,495.4	21.4	264.2	3.8	826.4	11.8	2,586.0	37.1
1991	6,606.4	1,251.2	18.9	313.2	4.7	920.0	13.9	2,484.4	37.6
1992	7,124.7	1,302.0	18.3	309.5	4.3	618.8	8.7	2,230.3	31.3
1993	7,547.4	1,531.5	20.3	367.9	4.9	712.4	9.4	2,611.8	34.6
1994	7,268.3	1,385.3	19.1	374.8	5.2	970.4	13.4	2,730.5	37.6
1995	7,457.8	1,335.6	17.9	420.2	5.6	523.9	7.0	2,279.7	30.6
1996	7,673.4	1,405.8	18.3	438.2	5.7	651.2	8.5	2,495.2	32.5
1997	7,966.2	1,734.6	21.8	506.3	6.4	538.5	6.8	2,779.5	34.9
Results For the Period									
Total Change (%)		288.5	113.7	269.8	106.5	173.6	51.1	256.3	95.0
Yearly Average (%)	10.0	5.5		10.0	5.2	7.0	2.9	9.0	4.8
Period's Average (%)			17.3		4.3		9.6		31.2

--Shares are calculated by using the statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, 1998 Lefkoşa, Tables-1,15, pp 1, 24.

3.2 Public Expenditures

Public expenditures are the monetary expenditures done by the public authorities within certain rules, in order to meet the pubic needs and/or, in order to intervene in the economic and social life.[19]

Public expenditures in the TRNC are composed of three main elements, which are:

i- Current Expenditures
ii- Public Investments
iii- Transfer Payments.

[19] İsmail Türk, **KAMU MALİYESİ**, Turhan Kitabevi, 1996 Ankara, p.25.

It will be noticed in the next chapter that when the budget expenditures of the state budget balance is considered, another component which is the *Defence Expenditures,* comes into the question in addition to the three components above. The reason that the defence expenditures are not shown as a separate component in this chapter is, because they are included in the current expenditures when general balance of public sector is under consideration.

On the other hand, the difference between the general balance of public sector and the state budget balance (balance of state revenues and expenditures) is due to the coverage of their components. That is, current expenditures, investments and transfer payments cover the related expenses of the public institutions or units such as the Central Bank and Development Bank when the balance of public sector is under consideration, where as these expenses are not included in the state budget balance. State budget balance only considers the expenditures and revenues of the state organization such as ministries. This is the reason for the differences in figures of similar items between the Tables 2.1, 2.2 and 3.1, 3.2.

Within the context of this study, Public Expenditures are sometimes referred to as "Total Public Expenditures" in order to imply that they are composed of the sum of the three elements mentioned above.

3.2.1 Current Expenditures

It is the current expenditures that cover the highest share of the public expenditures. They are the expenditures made on personnel wages and salaries and also the other current expenditures:
- Victuals
- Post, telephone, cleaning expenses
- Consumed goods and purchased supplies
- Fixtures and other payments.[20]

[20] Ekonomi ve Maliye Bakanlığı, op.cit., p.65.

3.2.2 Public Investments

Public investments consist of the money spend on:

- Infrastructure for transportation and communication;
- Buildings for constructions and extensive restorations;
- Constructions and caring of water walls;
- Agriculture and forestry;
- Vehicles and machinery;
- Infrastructure for tourism and industry;
- Social services.[21]

3.2.3 Transfer Payments

The second biggest share of expenditures is realized by transfer payments. The transfers are made up of:

i- Social Transfers:

Pensions given to the pensioners, fees to social security fund, aid to the poor, scholarships, aid to martyr families and war veterans are the payments made under the heading of social transfers.

ii- Other Transfers:

They are financial and economic transfers:

Financial transfers:

- Aid to sports federation
- Aid to Turk Agency Kıbrıs (State News Agency)
- Aid to political parties;
- Contribution to BRTK;
- Contribution to religious institutions.

Economic transfers:

- Contributions to institution of agriculture (TÜK);
- Transfers to municipalities and other local institutions
- Transfers to public enterprises for capital accumulation.[22]

---

[21] Ibid., p.19.
[22] Ibid., pp.20-21.

Public expenditures have increased from 12,300.8 Million TL in 1982 to 55,841,758.6 Million TL in 1997 at current prices. At 1977 constant prices, the public expenditures have increased from 1,574.0 Million TL in 1982 to 3,762.6 Million TL in 1997. This increase shows a total increase of 139.1% and yearly average rise of 5.8% within the period. The ratio of public expenditures to GNP has increased from 36.0% in 1982 to 47.0% in 1997. This result shows a total increase of 30.6% and yearly average rise of 1.8% in this ratio within the period (Table-2.5). The average ratio of public expenditures to GNP has been 40.3% for the period (Table-2.6).

Table-2.5 Public Expenditures (At 1977 prices, Million TL)

Years	Current Expend.	%	Investments	%	Transfers	%	Total Public Expenditures
1982	988.1	62.8	215.0	13.7	370.9	23.6	1,574.0
1983	892.2	52.5	355.5	20.9	453.1	26.6	1,700.8
1984	1,032.6	53.7	387.6	20.2	507.2	26.4	1,921.4
1985	1,056.0	52.5	335.0	16.6	622.1	30.9	2,013.1
1986	1,122.3	51.9	343.4	15.9	696.7	32.2	2,162.4
1987	1,174.0	49.5	452.8	19.1	746.4	31.5	2,373.2
1988	1,201.8	56.7	271.2	12.8	645.6	30.5	2,118.6
1989	1,233.4	58.6	310.0	14.7	559.6	26.6	2,103.0
1990	1,579.4	56.5	461.3	16.5	756.1	27.0	2,796.8
1991	1,719.1	59.9	271.8	9.5	880.4	30.7	2,871.3
1992	1,604.6	57.1	377.2	13.4	827.2	29.4	2,809.0
1993	1,656.3	53.5	492.0	15.9	950.4	30.7	3,098.7
1994	1,729.2	56.0	356.6	11.6	1,000.6	32.4	3,086.4
1995	1,712.7	52.7	270.3	8.3	1,266.9	39.0	3,249.9
1996	1,717.2	50.4	502.2	14.8	1,184.7	34.8	3,404.1
1997	1,961.6	52.1	499.3	13.3	1,301.7	34.6	3,762.6

--Shares are calculated by using the statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, 1998 Lefkoşa, Table-15, p.24.

Current expenditures have increased from 988.1 Million TL in 1982 to 1,961.6 Million TL in 1997 at 1977 constant prices within the period. This result shows a total increase of 98.5% and a yearly average rise of 4.6% during the period 1982-1997. The average share of current expenditures in total public expenditures has been 54.8% (Table-2.5). The ratio of current expenditures to GNP has increased steadily from 22.6% in 1982 to 24.6% in 1997. This result shows a total of 8.9% increase and a yearly average rise of 0.6% during the period. The average ratio of current expenditures to GNP has been 22.0% for the period (Table-2.5).

Public investments have increased from 215.0 Million TL in 1982 to 499.3 Million TL in 1997, at 1977 constant prices within the period. This result shows a total increase of 132.2% and a yearly average rise of 6.0% for the period. The average share of public investments in total public expenditures have been 14.8% (Table-2.5) for the period. The ratio of public investments to GNP has increased from 4.9% in 1982 to 6.3% in 1997. This result shows a total increase of 28.5% and yearly average of 1.8% in the ratio of investments to GNP within the period. The average ratio of investments to GNP has been 5.9% for the period (Table-2.6)

Table-2.6 Public Expenditures – Ratios to GNP - (At 1977 prices, Million TL)

Years	GNP	Current Expend.	% GNP	Transfers	% GNP	Public Investments	% GNP	Total Public Expend.	% GNP
1982	4,369.5	988.1	22.6	370.9	8.5	215.0	4.9	1,574.0	36.0
1983	4,440.4	892.2	20.1	453.1	10.2	355.5	8.0	1,700.8	38.3
1984	4,725.2	1,032.6	21.9	507.2	10.7	387.6	8.2	1,927.4	40.8
1985	5,080.4	1,056.0	20.8	622.1	12.2	335.0	6.6	2,013.1	39.6
1986	5,324.1	1,122.3	21.1	696.7	13.1	343.4	6.4	2,162.4	40.6
1987	5,684.1	1,174.0	20.7	746.4	13.1	452.8	8.0	2,373.2	41.8
1988	6,084.0	1,201.8	19.8	645.6	10.6	271.2	4.5	2,118.6	34.8
1989	6,603.0	1,233.4	18.7	559.6	8.5	310.0	4.7	2,103.0	31.9
1990	6,977.4	1,579.4	22.6	756.1	10.8	461.3	6.6	2,796.8	40.1
1991	6,606.4	1,719.1	26.0	880.4	13.3	271.8	4.1	2,871.3	43.5
1992	7,124.7	1,604.6	22.5	827.2	11.6	377.2	5.3	2,809.0	39.4
1993	7,547.4	1,656.3	22.0	950.4	12.6	492.0	6.5	3,098.7	41.1
1994	7,268.3	1,729.2	23.8	1,000.6	13.8	356.6	4.9	3,086.4	42.5
1995	7,457.8	1,712.7	23.0	1,226.9	16.5	270.3	3.6	3,209.9	43.0
1996	7,673.4	1,717.2	22.4	1,184.7	15.4	502.2	6.5	3,404.1	44.4
1997	7,966.2	1,961.6	24.6	1,301.7	16.3	499.3	6.3	3,762.6	47.2
Results For the Period									
Total Change (%)	98.5	8.9	251.0	91.8	132.2	28.5	139.1	31.1	
Yearly Average (%)	5.0	1.0	9.0	4.7	6.0	1.8	6.0	1.9	
Period's Average (%)		22.0		12.3		5.9		40.3	

--Shares are calculated by using the statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, 1998 Lefkoşa, Tables-1,15, pp 1, 24.

Transfers have increased from 370.9 Million TL in 1982 to 1,301.7 Million TL in 1997, at 1977constant prices. This result shows a total increase of 251% and a yearly average rise of 8.0% for the period.

The average share of the transfers in total public expenditures has been 30.4% for the period (Table-2.5). The ratio of transfers to GNP has increased from 8.5% in 1982 to 16.3% in 1997. This result shows a total increase of 91.8% and a yearly average rise of 4.3% in the ratio of transfers to GNP. The average ratio of transfers to GNP for the period has been 12.3% (Table-2.6). Composition of Public Expenditures of can be seen in Graph-2.2b.

It is obvious from Table-2.6 that public expenditures in general and transfer payments in particular have risen at a faster rate than the GNP during the period of 1982-1997. This situation is in accordance with the hypothesis which is often called *Wagner's Law*, after Adolph Wagner, the 19th century economist who formulated it.[23] Wagner's Law states that the public expenditure increases as the income level of a country increases.

3.3 Public Deficit

Public Deficit, which is the difference of public revenues and public expenditures, has increased from 793.8 Million TL in 1982 to 983.2 Million TL in 1997 at 1977 constant prices. This result shows a total increase of 23.9% and a yearly average rise of 1.4% for the period in real terms (Table2.2).

On the other hand, the ratio of public deficit to GNP has decreased from 18.1% in 1982 to 12.3% in 1997 (Table-2.7). This result shows a total decrease in the ratio of public deficit to GNP, of 32.0% and a yearly average decline of 2.6% within the period. In spite of the fact that this ratio has decreased in the period, we have to note that it is still preserving its existence significantly. Also, it is noticeable that in 1997, which is the last year of the period, the ratio of public deficit to total public revenues has been 35.4%.

---

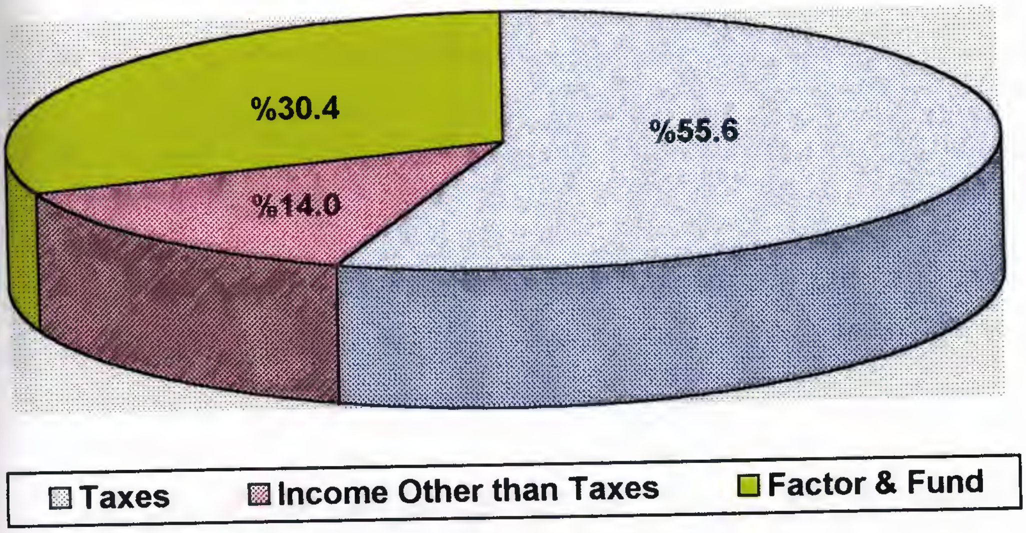
[23] Harvey S. Rosen, op.cit., p.142.

Table-2.7	Balance of Public Revenues and Expenditures (At 1977 prices, Mil. TL and Shares in GNP)					
Years	**Total Public Revenues**	**% GNP**	**Total Public Expend.**	**% GNP**	**Public Deficit**	**% GNP**
1982	780.2	17.9	1,574.0	36.0	-793.8	-18.1
1983	1,155.0	26.0	1,700.8	38.3	-544.8	-12.3
1984	1,281.3	27.1	1,927.4	40.8	- 646.1	-13.7
1985	1,289.1	25.4	2,013.1	39.6	-724.0	-14.2
1986	1,342.0	25.2	2,162.4	40.6	-820.4	-15.4
1987	1,851.0	32.6	2,373.2	41.8	-522.2	-9.2
1988	2,240.8	36.8	2,118.6	34.8	122.2	2.0
1989	2,081.3	31.5	2,103.0	31.9	21.7	0.4
1990	2,586.0	37.1	2,796.8	40.1	-210.3	-3.0
1991	2,484.4	37.6	2,871.3	43.5	-386.9	-5.9
1992	2,230.3	31.3	2,809.0	39.4	-578.7	-8.1
1993	2,611.8	34.6	3,098.7	41.1	-486.9	-6.5
1994	2,730.5	37.6	3,086.4	42.5	-355.9	-4.9
1995	2,279.7	30.6	3,209.9	43.0	-930.2	-12.4
1996	2,495.2	32.5	3,404.1	44.4	-908.9	-11.9
1997	2,779.5	34.9	3,762.6	47.2	-983.2	-12.3

--Shares are calculated by using the statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, 1998 Lefkoşa, Tables-1,15, pp 1, 24.

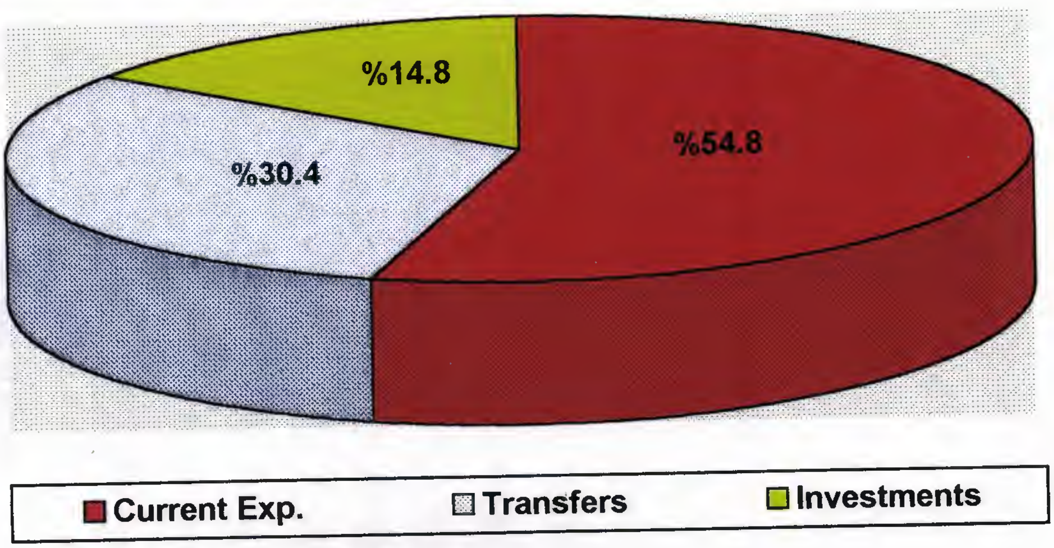
Evolution of Public Deficits together with the expenditures and the revenues in the TRNC can be seen in Graph-2.2a and Graph-2.2b. For preparing the Graphs 2.2a and 2.2.b, ratios of public revenues, expenditures and deficits to GNP have been plotted versus years for the period of 1982-1997.

Graph-2.1a Public Revenues



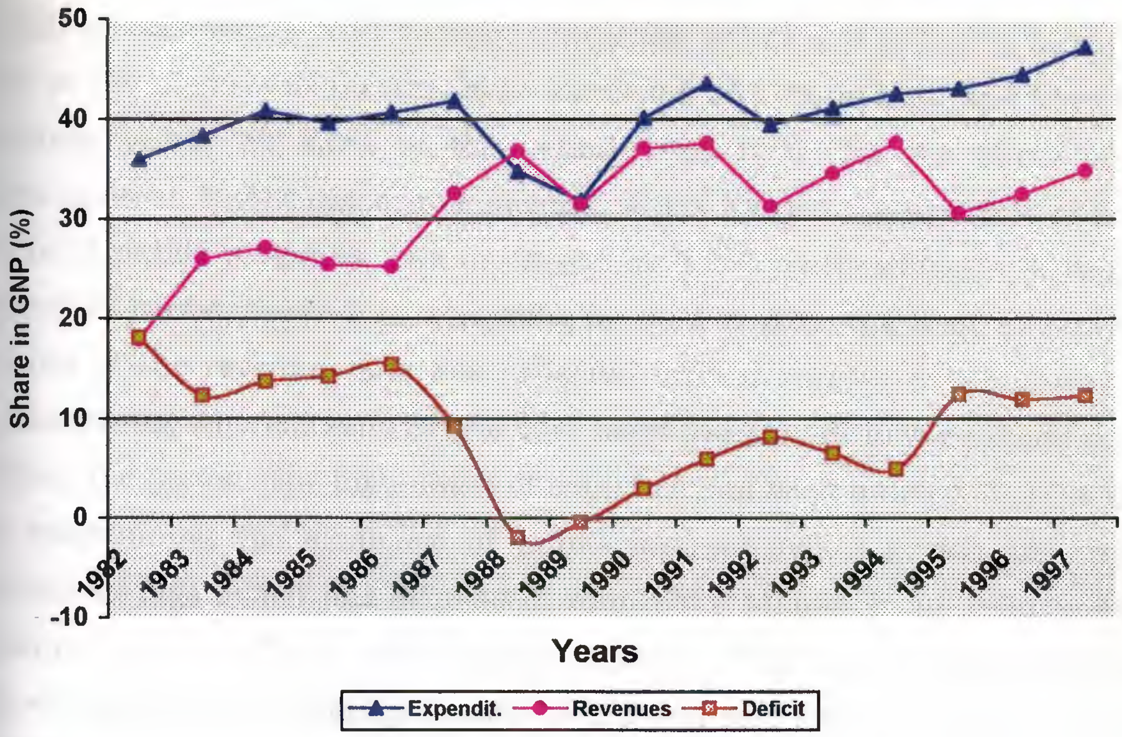
-- Period's average shares are plotted.

Graph-2.1b Public Expenditures

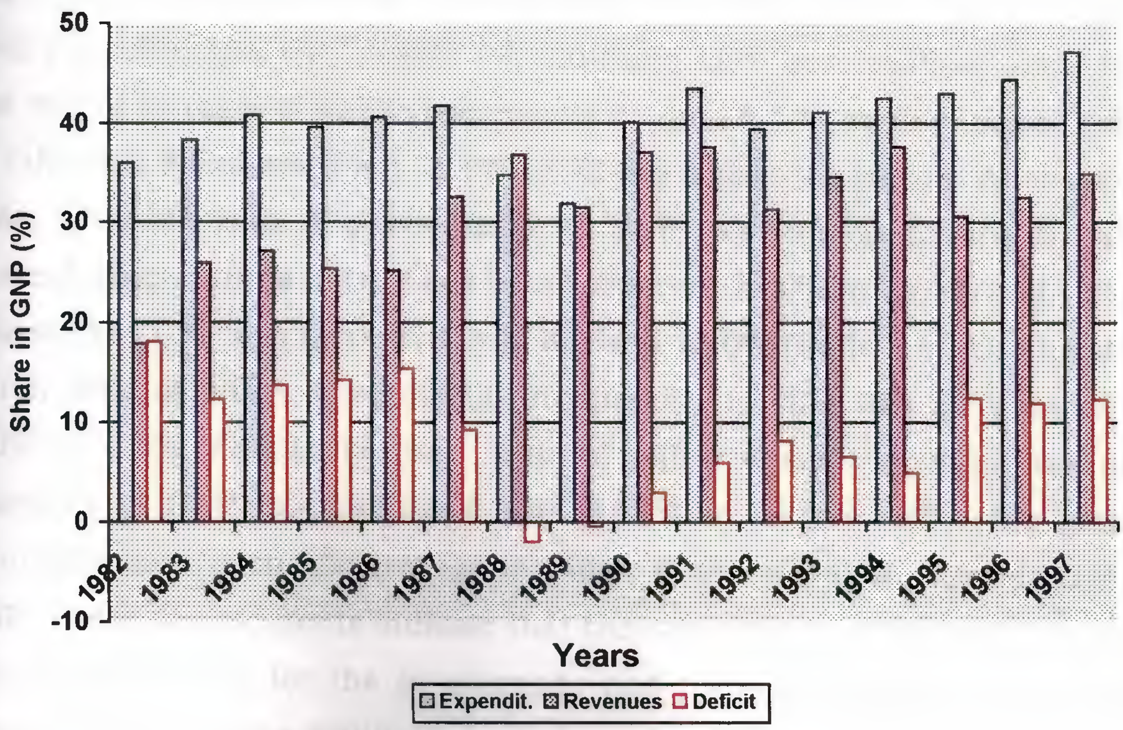


-- Period's average shares are plotted.

Graph-2.2a Evolution of Public Deficits of the TRNC



Graph-2.2b Evolution of Public Deficits of the TRNC



4. Conclusion

Analysis has shown that transfer payments, which are reducing factors for the public disposable income, have increased 251.0% in total and have risen average yearly by 8.0% in the period 1982-1997. By the effect of this development, Public disposable income, which has an average ratio of 61.0% to total public revenues, has increased by 9.0% yearly average, during the specified period (Table-2.2). According to these results, the state has directed 61.0% of the revenues she has collected, to her current expenditures and investments, whereas only 39.0% have been transferred to the private sector, within the period. The high share of transfers has been a determinative issue in maintaining the existence of public savings deficit during the period. Public savings deficit has decreased from 578.8 Million TL in 1982 to 483.9 Million TL in 1997, at 1977 constant prices, showing a total decrease of 16.4% and a yearly average decline of 1.0% in real terms, during the period (Table-2.2).

It is also seen that, public current expenditures have increased by 4.6% yearly average in real terms while public investments have increased by 5.6% yearly average in real terms during the period. As a result of the fact that rate of increase of current expenditures have been realized lower than the rate of increase of public revenues (4.6% and 8.5%), ratio of public deficit to GNP has decreased from 18.0% to 12.0% within the period. At the same time, while the ratio of public deficit to GNP has decreased, ratio of public current expenditures to GNP has increased from 23.0% to 25.0% and ratio of transfers to GNP has increased from 8.0% to 16.0% (Table-2.6). On the other hand, ratio of public fixed capital investments to GNP has increased from 5.0% to 6.0%. As can be seen, ratio of public current expenditures plus transfers to GNP has increased from 31.0% to 41.0% within the period. Transfers have been effective for the high share of public expenditures in GNP. These developments indicate that the state has reserved fewer share of revenues or funds for the investments and transfers formed a significant share of expenditures within the period.

As a result of the policies implemented during the period 1982-1997, public revenues have increased and the public deficit has decreased. But on the other hand, the aims of reducing the public expenditures and increasing the public investments, together with establishing a more efficient public sector and establishing a just tax system have not been achieved during the period. The objective of increasing the public revenues has been achieved at the expense of increasing the tax burden and restricting the investments.

By privatisation, the high share of the public sector in the economy will be reduced, private sector will be encouraged and efficiency will be increased. However, the process has not been completed yet, and the high burden of Public Enterprises still continues.

As known, public revenues plays a role in the formation and development of capital sources, while great importance is attached to the form of using the public expenditures from the aspects of accumulation of capital, production and employment. When we consider the structure and development of public expenditures in the TRNC, we can say that their contribution from the aspects of accumulation of capital and increasing production is very limited. Especially, the high share and the direction of development of transfers which, are not in return of production and services, show that the TRNC is deviating from the effective use of the public sources.

But on the other hand, we should not disregard the fact that transfer payments act like increases in autonomous spending in their effect on equilibrium income. Transfers raise autonomous consumption spending by the marginal propensity to consume.[24] An increase in transfer payments increases autonomous demand therefore increasing the income by the marginal propensity to consume. Also, it is another fact that transfer payments do not create any direct effect on national income, but only causes the transfer of purchasing power between the social sections or individuals.[25]

---

[24] Dornbush and Fischer, op.cit., p.70.

[25] Prof.Dr. Şevki ÖZBİLEN, op.cit., p.75.

III. THE BUDGET

1. Introduction

Fiscal activities of the government influence the economic and social life too. Because of this, fiscal activities of the government should be performed with care. Today, the use of fiscal policy tools directs economic and social life. Because of this, the budget is not only a tool for determining the public revenues and expenditures according to the public needs and finding sources for them, but also is an important tool for realising the planned growth and social structure while targeting the struggle against inflation. More briefly, budget is a legal document, stating the decisions and preferences about communal goods and services together with the sources and revenues.[26] Improvement of the infrastructure through the effective and efficient use of the national resources, increase in the production of goods and services, improvement of the distribution of income, expansion of social justice, overcoming the regional imbalances and increase in the level of public services are all targeted by the budget.

The budget has started to be used more as a tool due to the increase in public services and activities. It is also used to control the aggregate demand and supply equilibrium in the economy.

In Chapter II, general balance of the public sector has been examined and the fiscal policy tools are identified. Note that, not only the budget itself, but also the elements and sub-elements that set up the budget are the fiscal policy tools.

In this chapter, the evolution of the budget in the TRNC for the period 1977-1997 will be examined in detail, and the elements and the sub-elements of the budget will be studied separately for the structural analysis of the budget of the TRNC. The analysis will end with conclusions and comments.

[26] Şerafettin Aksoy, **KAMU MALİYESİ**, Filiz Kitabevi, 1998 İstanbul, p.386.

2. Structural Analysis of the TRNC Budget

The budget of TRNC is composed of three main elements. These are:

1- Budget Expenditures;

2- Budget Revenues;

3- Foreign Aid and Borrowings.[27]

2.1 Budget Expenditures of the TRNC

Characteristics and the level of budget expenditures are the determining elements for the development of a country. The state expenditures are effective in determining the use of sources by the state, the sources of income, the accumulation capital and the use of private sources. Specially, in attaining the targets and the aims set on production, in creating employment and price stability, budget expenditures can directly be used as an effective tool as mentioned in Chapter II.

Related with these characteristics, when we analyse budget expenditures part of the budget of the TRNC, we see that, they have risen from 1,186.1 million TL to 50,160,862.0 million TL between the years 1977 and 1997 with current prices, and from 1,186.1 million TL to 3,379.9 million TL at 1977 prices (Table-3.1, Table-3.2). According to these values, the budget expenditures have grown by 185.0% in real terms for the specified period. This is a 5.2% rise on the average, yearly.

When we compare the rise with respect to current and 1977 prices, it can easily be realized that economy of the TRNC has faced a high inflation between the specified years.

[27] KKTC Başbakanlık, DPÖ, **EKONOMİK VE SOSYAL GÖSTERGELER**, 1998 Lefkoşa, p.27.

Besides the effects it has created on the economy in general, high rate of price changes has also affected the budget. Nevertheless, the share of expenditures has shown a total of 11.2% rise, from 31.2% to 42.4% in GNP between the years 1977-1997.

Budget expenditures of the TRNC consist of four sub-elements. These are given below.

2.1.1 Current Expenditures

As mentioned in the previous chapter, current expenditures cover the highest share of the budget expenditures. They are the expenditures made on personnel wages and salaries. Also, the other current expenditures such as victuals, post, telephone and cleaning expenses, consumed goods and purchased supplies, fixtures and other payments are all done under this heading.[28]

Current expenditures have increased from 668 million TL to 20,375,173.6 million TL at current prices for the period 1977-1997 (Table-3.1). With constant prices the current expenses have risen from 668.0 to 1,372.9 million TL for the same period (Table-3.2).

According to the data, current expenditures have risen by 105.5% with constant prices, within the specified period. Average share of current expenditures in total budget expenditures has been realized as 48.2% for the specified period, where 40.1% of this is the share of personnel expenditures and 8.1% of this is the share of other current expenditures.

[28] Ekonomi ve Maliye Bakanlığı, op.cit., p.65.

2.1.2 Transfer Payments

The second biggest share of budget expenditures is realized by transfer payments. The transfer payments are made up of *social transfers*, and *other transfers* as explained in the previous chapter. Some examples of *social transfers* are pensions given to the pensioners, aid to the poor, scholarships, aid to the war veterans and to the martyr families. *Other transfers* are done in the form of financial transfers and economic transfers. Some examples of financial transfers are, aids to sports federations, to Turk Agency Kıbrıs , to political parties and contributions to the state radio and television BRTK and to religious institutions. Besides these, contributions to institution of agricultural crops (TÜK), transfers to municipalities and transfers to public enterprises for capital accumulation are the examples of economic transfers.

Transfer payments have shown a steady growth from 283.7 million TL to 19,359,870.8 million TL with current prices and at the same time with constant prices, they have risen from 283.7 million TL to 1,304.5 million TL. This is a total of 359.8% and on the average 7.6% rise yearly. At the same time, share of transfers in GNP has grown from 7.5% to 16.4%, which is a total of 118.7% and 3.9% rise yearly. Average share of the transfer payments in total budget expenditures has been realized as 33.3% for the period of 1977-1997.

2.1.3 Defence Expenditures

Security Troops and Civil Defence are the institutions that are responsible for defending the nation. Defence expenditures are composed of the current expenditures, investment projects and transfer payments for these institutions. Due to the fact that most of the defence work is taken over by Turkish Army who are financed by the Turkish state, not much expenditure is done for defence by the state of the TRNC. For the years 1977-1997, the defence expenditures have risen from 143.6 million TL to 4,325,000.0

million TL at current prices. When these figures are analysed at constant prices, it can be seen that they have fluctuated over the years. In fact, the share of defence in GNP has shown a steady decrease from 3.8% in 1977 to 1.9% in 1996 indicating a total of 50.0%, and 3.5% yearly decrease on the average. Then, a sudden increase from 1.9% to 3.6% in 1997 is observed. This is due to the financing of defence projects implemented after the co-operation protocol with Turkey in 1997. Average share of the defence expenditures in total budget expenditures has been realized as 6.9% for the period 1977-1997.

2.1.4 Investments

As explained in the previous chapter, in the budget of the TRNC, *investments* consists of the money spend on:

- Infrastructure for transportation and communication;
- Buildings for constructions and extensive restorations;
- Constructions and caring of water walls;
- Agriculture and forestry;
- Vehicles and machinery;
- Infrastructure for tourism and industry;
- Social services.

Investments have shown a steady growth for the years 1977-1997. With current prices, investments have grown from 90.8 million TL to 6,100,817.6 million TL. When we analyse investments at constant prices they have increased by a total of 352.8% from 90.8 million TL to 411.1 million TL indicating a 7.6% rise yearly. The share of investment expenditures in total budget expenditures has increased from 7.7% in 1977 to12.2% in 1997. At the same time, the share of investments in GNP has increased from 2.4 % to 5.2%. Average share of investment expenditures in the budget expenditures has been realized as 11.6% for the period 1977-1997.

The structural analysis shows that the share of current expenditures is too high compared with the other elements of budget expenditures (Table-3.4). The share of current expenditures has shown a steady decrease from 56.3% to 40.6% in total budget expenditures, although there has been 105.5% rise in the current expenditures between 1977 and 1997, at constant prices. On the average, 80% of all current expenditures go to personnel and the rest 20% is spent on other expenditures such as telephone, post, fixtures etc. Between the years 1977-1982, the share of other expenditures was 11.2%, whereas by the years 1983-1997, this share has declined to 6.9% on the average. In total, current expenditures, including both the personnel and the other expenditures, have declined. However, current expenditures' share is still higher than other budget expenditures. The main reason which causes the current expenditures share to be high is the fact that public sector is over employed and moreover, the state is still employing more people. When the statistics are analysed, the number of people employed by the state from 1977 to 1997 has shown a 25.0% increase from 13,076.0 to 16,972.0.[29] Although there has been a 25.0% increase, the share of public services in GNP has shown a decrease from 19.9% in 1977 to 17.1% by 1997.[30]

---

[29] KKTC Başbakanlık, DPÖ, **EKONOMİK VE SOSYAL GÖSTERGELER**, 1998 Lefkoşa, p.61.
[30] Ibid., p.6.

Table-3.1 BALANCE OF STATE REVENUES AND EXPENDITURES

(Current Prices, MillionTL)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
I. Local Revenues	627.1	799.7	1,267.6	1,992.0	3,449.9	4,559.1	8,638.8	13,159.1	21,496.0	33,281.0	59,034.0
1.Tax Revenues	408.0	598.0	815.1	1,397.4	2,592.8	3,489.1	6,723.1	10,578.7	17,580.0	26,329.5	48,246.9
a) Direct Taxes	135.9	183.4	281.7	447.4	990.2	1,515.0	2,895.1	5,004.5	8,592.0	14,496.3	26,227.4
b) Indirect Taxes	272.1	414.6	533.4	950.0	1,602.6	1,974.1	3,828.0	5,574.2	8,988.0	11,833.2	22,019.5
2. Other Income	219.7	201.7	452.5	594.6	857.1	1,070.0	1,915.7	2,580.4	3,916.0	6,951.5	10,787.1
3. Fund Revenues	-	-	-	-	-	-	-	-	-	-	-
II. Expenditures	1,186.1	1,435.3	2,394.0	4,209.2	7,219.8	9,690.2	16,274.2	26,964.0	45,788.7	70,474.0	106,054.3
1. Current Expenditures	668.0	776.6	1,314.3	2,422.0	3,795.6	4,401.0	7,575.1	12,405.9	20,167.5	32,418.2	45,966.5
a) Personal Expenditures	553.3	627.1	991.5	1,971.1	3,012.1	3,271.8	6,032.0	10,262.7	17,229.9	27,676.0	39,041.3
b) Other Current Expenditure	114.7	149.5	322.8	450.9	783.5	1,129.2	1,543.1	2,143.2	2,937.6	4,742.2	6,952.2
2. Transfers	283.7	406.6	741.0	1,063.3	1,698.0	2,899.0	4,801.1	7,935.7	15,534.8	25,529.7	37,954.4
a) Social Transfers	-	-	560.7	674.6	1,238.5	2,248.0	3,358.8	5,081.8	10,336.0	15,594.1	25,315.5
b) Other Transfers	-	-	180.3	388.7	459.5	651.0	1,442.3	2,853.9	5,198.8	9,935.6	12,638.9
3. Defence	143.6	124.9	198.9	325.8	548.6	757.9	1,261.7	2,537.9	3,598.4	4,982.0	5,980.0
4. Investments	90.8	127.2	139.8	398.1	1,177.6	1,632.3	2,636.3	4,079.5	6,488.0	7,544.1	16,153.4
III. Foreign Aid And Loans	558.4	635.6	1,126.4	2,217.2	3,769.9	5,131.1	7,635.4	13,804.9	24,292.7	37,193.0	47,020.3
1. Foreign Aid	193.6	271.6	425.0	645.6	1,745.1	2,274.3	3,912.7	7,015.1	11,787.9	14,607.6	25,902.4
a) Aid From Turkey	193.6	220.5	374.1	606.6	1,720.7	2,236.6	3,866.2	6,961.8	10,450.9	11,701.7	19,942.6
b) Other Foreign Aid	-	51.1	50.9	39.0	24.4	37.7	46.5	53.3	1,337.0	2,905.9	5,959.8
2. Loans	364.8	364.0	701.4	1,571.6	2,024.8	2,856.8	3,722.7	6,789.8	12,504.8	22,585.4	21,117.9
a) Internal Loans	88.8	74.7	34.8	30.3	-	-	-	-	3,754.8	4,585.4	11,117.9
b) Foreign	276.0	289.3	666.6	1,541.3	2,024.8	2,856.8	3,722.7	6,789.8	8,750.0	18,000.0	10,000.0
GNP	3,810.5	5,251.0	8,504.5	17,541.5	24,525.6	34,148.0	47,040.2	73,937.8	126,874.2	195,142.7	289,106.4

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
I. Local Revenues	109,183.3	195,748.7	390,329.1	521,869.3	876,946.5	1,689,502.0	4,748,525.1	8,463,386.0	15,528,392.7	34,385,089.9
1.Tax Revenues	90,713.0	162,989.3	331,717.8	425,804.3	728,738.0	1,392,382.4	3,129,140.4	6,202,681.8	11,366,588.0	25,100,952.4
a) Direct Taxes	47,205.7	84,424.3	166,109.9	243,580.9	392,651.3	727,805.0	1,813,865.8	3,661,102.4	6,518,720.4	14,161,807.2
b) Indirect Taxes	43,507.3	78,565.0	165,607.9	182,223.4	336,086.7	664,577.4	1,315,274.6	2,541,579.4	4,847,867.6	10,939,145.2
2. Other Income	18,470.3	32,759.4	58,611.3	96,065.0	148,208.5	297,119.6	757,998.0	1,609,116.6	3,138,274.4	6,551,492.3
3. Fund Revenues	-	-	-	-	-	-	861,386.7	651,587.6	1,023,530.3	2,732,645.2
II. Expenditures	150,702.2	257,142.9	524,749.0	891,063.2	,369,323.9	2,504,274.9	6,260,479.1	13,655,393.2	24,380,624.4	50,160,862.0
1. Current Expenditures	75,886.9	129,114.0	247,636.2	400,163.9	654,652.1	1,162,462.7	3,037,803.5	6,263,359.4	10,671,604.0	20,375,173.6
a) Personal Expenditures	65,663.5	108,093.1	206,942.8	341,748.5	557,737.0	973,752.4	2,669,305.3	5,509,473.8	9,275,954.3	17,756,985.3
b) Other Current Expenditure	10,223.4	21,020.9	40,693.4	58,415.4	96,915.1	188,710.3	368,498.2	753,885.6	1,395,649.7	2,618,188.3
2. Transfers	55,222.3	85,584.6	182,573.9	331,505.7	496,217.1	901,119.5	2,303,510.4	5,794,161.5	9,867,171.5	19,359,870.8
a) Social Transfers	36,675.3	64,262.9	144,852.1	231,674.0	398,854.7	693,920.0	1,821,121.8	5,002,953.9	7,682,524.6	13,945,813.8
b) Other Transfers	18,547.0	21,321.7	37,721.8	99,831.7	97,362.4	207,199.5	482,388.6	791,207.6	2,184,646.9	5,414,057.0
3. Defence	8,564.7	12,550.0	20,140.0	46,975.0	84,150.0	126,100.0	310,265.8	747,500.0	1,247,500.0	4,325,000.0
4. Investments	11,028.3	29,894.3	74,398.9	112,418.6	134,304.7	314,592.7	608,899.4	850,372.3	2,594,348.9	6,100,817.6
III. Foreign Aid And Loans	41,518.9	61,394.2	134,419.9	369,193.9	492,377.4	814,772.9	1,511,954.0	5,192,007.2	8,852,231.7	15,775,772.1
1. Foreign Aid	22,132.4	37,192.9	50,884.9	113,680.3	150,698.5	296,341.6	632,062.4	1,294,957.6	6,226,437.9	12,281,476.4
a) Aid From Turkey	15,455.0	33,297.3	48,988.6	109,767.6	149,212.7	294,885.0	621,234.9	1,253,647.9	6,119,642.4	12,171,847.1
b) Other Foreign Aid	6,677.4	3,895.6	1,896.3	3,912.7	1,485.8	4,456.6	10,827.5	41,309.7	106,795.4	109,629.3
2. Loans	19,386.5	24,201.3	83,535.0	255,513.6	341,678.9	518,431.3	879,891.6	3,897,049.6	2,625,793.8	3,494,295.7
a) Internal Loans	19,386.5	24,201.3	73,535.0	156,813.6	237,121.8	517,321.7	879,891.6	3,897,049.6	2,125,793.8	3,494,295.7
b) Foreign	-	-	10,000.0	98,700.0	104,557.1	1,109.6	-	-	500,000.0	-
GNP	485,848.2	910,058.6	1,547,793.0	2,273,698.1	,037,702.2	6,941,224.3	6,941,224.3	35,178,971.7	63,576,940.3	118,227,359.0

Source:KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-18, 1998 Lefkoşa, pp.27,28.

Table-3.2 BALANCE OF STATE REVENUES AND EXPENDITURES

(1977 Prices, Million TL)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
I. Local Revenues	627.7	610.3	627.6	482.5	552.8	583.4	815.5	841.0	860.8	908.0	1,160.7	1,367.2	1,420.3	1,759.6	1,516.3	1,547.4	1,837.1	2,081.5	1,794.2	1,874.2	2,316.9
1. Tax Revenues	408.0	456.4	403.6	338.5	415.4	446.5	634.6	676.1	704.0	718.3	948.6	1,135.9	1,182.6	1,495.4	1,237.2	1,285.9	1,514.0	1,371.6	1,314.9	1,371.9	1,691.3
a) Direct Taxes	135.9	140.0	139.5	108.4	158.6	193.9	273.3	319.9	344.1	395.5	515.7	591.1	612.6	748.8	707.7	692.9	791.4	795.1	776.1	786.8	954.2
b) Indirect Taxes	272.1	316.4	264.1	230.1	256.8	252.6	361.3	356.2	359.9	322.8	432.9	544.8	570.0	746.6	529.5	593.0	722.6	576.5	538.8	585.1	737.1
2. Other Income	219.7	153.9	224.0	144.0	137.4	136.9	180.9	164.9	156.8	189.7	212.1	231.3	237.7	264.2	279.1	261.5	323.1	332.3	341.1	378.8	441.5
3. Fund Revenues	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	377.6	138.2	123.5	184.1
II. Expenditures	1,186.1	1,095.3	1,185.3	1,019.5	1,156.8	1,240.0	1,536.2	1,723.2	1,833.5	1,922.8	2,085.2	1,887.1	1,865.7	2,365.6	2,589.0	2,416.2	2,723.0	2,744.2	2,894.9	2,942.6	3,379.9
1. Current Expenditures	668.0	592.6	650.7	586.6	608.1	563.2	715.1	793.1	807.5	884.5	903.8	950.3	936.8	1,116.4	1,162.7	1,155.1	1,264.0	1,331.6	1,327.8	1,288.0	1,372.9
a) Personal Expenditures	553.3	478.5	490.9	477.4	482.6	418.7	569.4	655.8	689.9	755.1	767.6	822.3	784.3	932.9	993.0	984.1	1,058.8	1,170.1	1,168.0	1,119.6	1,196.5
b) Other Current Expenditures	114.7	114.1	159.8	109.2	125.5	144.5	145.7	137.3	117.6	129.4	136.2	128.0	152.5	183.5	169.7	171.0	205.2	161.5	159.8	168.4	176.4
2. Transfers	283.7	310.3	366.9	257.6	272.1	370.9	453.2	507.2	622.1	696.5	746.2	691.5	621.0	823.0	963.2	875.6	979.8	1,009.7	1,228.3	1,190.9	1,304.5
a) Social Transfers	-	-	277.6	163.4	198.5	287.6	317.1	324.8	413.9	425.4	497.7	459.3	466.3	653.0	673.1	703.8	754.5	798.3	1,060.6	927.2	939.7
b) Other Transfers	-	-	89.3	94.2	73.6	83.3	136.1	182.4	208.2	271.1	248.5	232.2	154.7	170.0	290.1	171.8	225.3	211.4	167.7	263.7	364.8
3. Defence	143.6	95.3	98.5	78.9	87.9	97.0	119.1	162.2	144.1	135.9	117.6	107.2	91.0	90.8	136.5	148.5	137.1	136.0	158.5	150.6	291.4
4. Investments	90.8	97.1	69.2	96.4	188.7	208.9	248.8	260.7	259.8	205.8	317.6	138.1	216.9	335.4	326.6	237.0	342.1	266.9	180.3	313.1	411.1
III. Foreign Aid And Loans	558.4	485.0	557.7	537.0	604.0	656.6	720.7	882.2	972.7	1,014.8	924.5	519.9	445.4	606.0	1,072.7	868.8	885.9	662.7	1,100.7	1,068.4	1,063.0
1. Foreign Aid	193.6	207.3	210.4	156.4	279.6	291.0	369.3	448.3	472.0	398.6	509.3	277.1	269.8	229.4	330.3	265.9	322.2	277.0	274.5	751.5	827.5
a) Aid From Turkey	193.6	168.3	185.2	146.9	275.7	286.2	364.9	444.9	418.5	319.3	392.1	193.5	241.6	220.8	318.9	263.3	317.4	272.3	265.8	738.6	820.1
b) Other Foreign Aid	-	39.0	25.2	9.5	3.9	4.8	4.4	3.4	53.5	79.3	117.2	83.6	28.2	8.6	11.4	2.6	4.8	4.7	8.7	12.9	7.4
2. Loans	364.8	277.7	347.3	380.6	324.4	365.6	351.4	433.9	500.7	616.2	415.2	242.8	175.6	376.6	742.4	602.9	563.7	385.7	826.2	316.9	235.5
a) Internal Loans	88.8	57.0	17.2	7.3	-	-	-	-	150.3	125.1	218.6	242.8	175.6	331.5	455.6	418.4	562.5	385.7	826.2	256.6	235.5
b) Foreign Loans	276.0	220.7	330.1	373.3	324.4	365.6	351.4	433.9	350.4	491.1	196.6	-	-	45.1	286.8	184.5	1.2	-	-	60.3	-
GNP	3,810.5	4,031.3	4,210.1	4,248.4	3,929.8	4,369.5	4,440.4	4,725.2	5,080.4	5,324.1	5,684.1	6,084.0	6,603.0	6,977.4	6,606.4	7,124.7	7,547.4	7,268.3	7,457.8	7,673.4	7,966.2

Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-19, 1998 Lefkoşa, pp.29.30.

Table-3.3 BALANCE OF STATE REVENUES AND EXPENDITURES

(Share in GNP)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
I. Local Revenues	16.5	15.1	14.9	11.4	14.0	13.4	18.4	17.8	16.9	17.0	20.4	22.5	21.5	25.2	23.0	21.7	24.3	28.6	24.0	24.4	29.1
1.Tax Revenues	10.7	11.3	9.6	8.0	10.5	10.3	14.3	14.3	13.9	13.5	16.7	18.7	17.9	21.4	18.7	18.0	20.0	18.8	17.6	17.9	21.3
a) Direct Taxes	3.6	3.5	3.3	2.6	4.0	4.5	6.2	6.8	6.8	7.4	9.1	9.7	9.3	10.7	10.7	9.7	10.5	10.9	10.4	10.3	12.0
b) Indirect Taxes	7.1	7.8	6.3	5.4	6.5	5.8	8.1	7.5	7.1	6.1	7.6	9.0	8.6	10.7	8.0	8.3	9.5	7.9	7.2	7.6	9.3
2. Other Income	5.8	3.8	5.3	3.4	3.5	3.1	4.1	3.5	3.0	3.5	3.7	3.8	3.6	3.8	4.3	3.7	4.3	4.6	4.6	4.9	5.5
3. Fund Revenues	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	5.2	1.8	1.6	2.3
II. Expenditures	31.2	27.2	28.1	24.0	29.4	28.4	34.6	36.5	36.1	36.1	36.7	31.0	28.3	33.9	39.2	33.9	36.0	37.8	38.8	38.3	42.4
1. Current Expenditures	17.5	14.7	15.5	13.8	15.5	12.9	16.1	16.8	15.9	16.6	15.9	15.6	14.2	16.0	17.6	16.2	16.7	18.3	17.8	16.8	17.2
a) Personal Expenditures	14.5	11.9	11.7	11.2	12.3	9.6	12.8	13.9	13.6	14.2	13.5	13.5	11.9	13.4	15.0	13.8	14.0	16.1	15.7	14.6	15.0
b) Other Current Expenditures	3.0	2.8	3.8	2.6	3.2	3.3	3.3	2.9	2.3	2.4	2.4	2.1	2.3	2.6	2.6	2.4	2.7	2.2	2.1	2.2	2.2
2. Transfers	7.5	7.7	8.7	6.0	6.9	8.5	10.2	10.7	12.2	13.1	13.1	11.4	9.4	11.8	14.6	12.3	13.0	13.9	16.5	15.5	16.4
a) Social Transfers	-	-	6.6	3.8	5.0	6.6	7.1	6.9	8.1	8.0	8.7	7.6	7.1	9.4	10.2	9.9	10.0	11.0	14.2	12.1	11.8
b) Other Transfers	-	-	2.1	2.2	1.9	1.9	3.1	3.8	4.1	5.1	4.4	3.8	2.3	2.4	4.4	2.4	3.0	2.9	2.3	3.4	4.6
3. Defence	3.8	2.4	2.3	1.9	2.2	2.2	2.7	3.5	2.9	2.5	2.1	1.7	1.4	1.3	2.1	2.1	1.7	1.9	2.1	1.9	3.6
4. Investments	2.4	2.4	1.6	2.3	4.8	4.8	5.6	5.5	5.1	3.9	5.6	2.3	3.3	4.8	4.9	3.3	4.5	3.7	2.4	4.1	5.2
III. Foreign Aid And Loans	14.7	12.1	13.2	12.6	15.4	15.0	16.2	18.7	19.2	19.1	16.3	8.5	6.8	8.7	16.2	12.2	11.7	9.2	14.8	13.9	13.3
1. Foreign Aid	5.1	5.2	5.0	3.7	7.1	6.7	8.3	9.5	9.3	7.5	9.0	4.5	4.1	3.3	5.0	3.7	4.3	3.8	3.7	9.8	10.4
2. Loans	9.6	6.9	8.2	8.9	8.3	8.3	7.9	9.2	9.9	11.6	7.3	4.0	2.7	5.4	11.2	8.5	7.4	5.4	11.1	4.1	2.9

Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-20, 1998 Lefkoşa, p.31.

Table-3.4	Budget Expenditures						(At 1977 prices, Million TL)				
Years	**Personnel Exp.**	%	**Transfers**	%	**Defence Exp.**	%	**Investment**	%	**Other Exp.**	%	**Total** (%100)
1977	553.3	46.6	283.7	23.9	143.6	12.1	90.8	7.7	114.7	9.7	1,186.1
1978	478.5	43.7	310.3	28.3	95.3	8.7	97.1	8.9	114.1	10.4	1,095.3
1979	490.9	41.4	366.9	31.0	98.5	8.3	69.2	5.8	159.8	13.5	1,185.3
1980	477.4	46.8	257.6	25.3	78.9	7.7	96.4	9.5	109.2	10.7	1,019.5
1981	482.6	41.7	272.1	23.5	87.9	7.6	188.7	16.3	125.5	10.9	1,156.8
1982	418.7	33.8	370.9	29.9	97.0	7.8	208.9	16.8	144.5	11.7	1,240.0
1983	569.4	37.0	453.2	29.5	119.1	7.8	248.8	16.2	145.7	9.5	1,536.2
1984	655.8	38.1	507.2	29.4	162.2	9.4	260.7	15.1	137.3	8.0	1,723.2
1985	689.9	37.6	622.1	33.9	144.1	7.9	259.8	14.2	117.6	6.4	1,833.5
1986	755.1	39.3	696.5	36.2	135.9	7.1	205.8	10.7	129.4	6.7	1,922.8
1987	767.6	36.8	746.2	35.8	117.6	5.7	317.6	15.2	136.2	6.5	2,085.2
1988	822.3	43.6	691.5	36.6	107.2	5.7	138.1	7.3	128.0	6.8	1,887.1
1989	784.3	42.0	621.0	33.3	91.0	4.9	216.9	11.6	152.5	8.2	1,865.7
1990	932.9	39.4	823.0	34.8	90.8	3.8	335.4	14.2	183.5	7.8	2,365.6
1991	993.0	38.3	963.2	37.2	136.5	5.3	326.6	12.6	169.7	6.6	2,589.0
1992	984.1	40.7	875.6	36.2	148.5	6.2	237.0	9.8	171.0	7.1	2,416.2
1993	1,058.8	38.9	979.8	36.0	137.1	5.0	342.1	12.6	205.2	7.5	2,723.0
1994	1,170.1	42.6	1,009.7	36.8	136.0	5.0	266.9	9.7	161.5	5.9	2,744.2
1995	1,168.0	40.4	1,228.3	42.4	158.5	5.5	180.3	6.2	159.8	5.5	2,894.9
1996	1,119.6	38.0	1,190.9	40.5	150.6	5.1	313.6	10.7	168.4	5.7	2,942.6
1997	1,196.5	35.4	1,304.5	38.6	291.4	8.6	411.1	12.2	176.4	5.2	3,379.9

--The shares are calculated by using the statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-19, 1998 Lefkoşa, pp.28,29.

This shows us that there is not a positive correlation between the increase in the number of people employed and the productivity of the public sector. So, high personnel expenditures, continuous increase in employment in public sector and also a high share of employment in the labour force, 20.4% in 1997, creates a high pressure on the budget expenditures.

At the same time, the share of transfer payments has increased from 23.9% in 1977 to 38.6% in 1997. One of the main reasons, which cause the share of transfer payments to increase, is the fact of early retirement law allowing people to retire with a 25 years work. This issue pushes up the social transfers so that people at the age of 50 can retire.

Although it has been stated by the Economic Co-operation Protocol signed with Turkey (1997), that the retirement payments for the state personnel would be taken out of the budget as a complementary measure for "single social security" system, preparations in this aspect have not been completed yet. The financial resources fulfilled by Turkey for this purpose have been used for meeting the short run resource needs and for meeting the budget deficits.[31]

It is obvious that the retirement payments must be taken out of the budget and the "single social security" system must follow at once; otherwise the practice of using the stated financial resource for other irrelevant purposes will lead to the prolongation of the problem.

On the other hand the fund given to the personnel as cost of living allowance under financial transfers is growing at an increasing rate due to inflation. Moreover, the municipalities also have high demands for aid from the central government. This has forced the economic transfers to be increased also.

All these mentioned factors, have made the share of transfer payments to grow to 38.6% of the budget which is nearly the amount spent on personnel working in the state. In the specified period, the share of defence has steadily declined from 12.1% in 1977 to 5.0% in 1993; and after the economic co-operation protocol with Turkey at the beginning of the year 1997. There has been a sudden increase to 8.6% in 1997. As mentioned before, this is due to the extensive implementation of the defence projects.

In general, the structure of the budget expenditures is not diverted to production and employment. The applied budget years 1977 to 1997 shows that the share of personnel, defence and the other current expenditures cover 51.1% of total expenditures on the average. At the same time, transfers have reached to 38.6%in 1977 and only 12.2% of total expenditures are allocated to investments from the budget. State personnel and the rise in personnel salaries increases the share of personnel expenditures. The rise in state employment is not only related to the progress of increases in public services. Due to the TRNC's special conditions, where the private sector is not developed enough to create employment and also in order to prevent

[31] KKTC Başbakanlık, DPÖ, 1999 **GEÇİŞ YILI PROGRAMI**, 1998 Lefkoşa, p.51.

young people from leaving the country (brain drain) and prevent unemployment and the consequent social unrest, state employs people without work. Therefore, finding a job in the public sector is not always related to the numerical or qualifying developments of the public sector. These issues worsen the situation of the public sector and it increases the expenditures of the budget and the cost of alternative financing.

In summing, the budget expenditures have shown an increasing tendency. The statistics shows to us that transfers are being the effective element in the rises of the budget expenditures. Unfortunately, the transfer payments are made without acquiring goods and services in return. This keeps the structure away from production, and directs it towards a poor production qualified budget. Even worse about the budget is the fact that, the total local revenues are not sufficient enough to meet current expenditures and transfer payments. In 1997, the total local revenues are 34,358,089.9 (at current prices) million TL, where the total of current expenditures and the transfers reach 39,735,044.4 million TL which is 5,376,955.5 million more than the revenues. This proves to us that the state has to borrow in order to pay its personnel and transfers. The investments are totally dependent both on the borrowings and the aid.

2.2 Budget Revenues of the TRNC

A state's ability to be alloyed to country's economy depends on the generated revenues and the ability to increase them. A country, which does not possess these characteristics, should not expect to be alloyed to the social and economical life of that country. In the budget of the TRNC, the revenues are collected under the heading of "Budget Local Revenues".

Local revenue part of the budget consists of three parts:

1) Tax revenues
2) Other income (revenues);
3) Fund revenues.[32]

---

[32] KKTC Başbakanlık, DPÖ, **EKONOMİK VE SOSYAL GÖSTERGELER**, 1998 Lefkoşa, p.27.

2.2.1 Tax Revenues

Tax revenues are made up of direct and indirect taxes. Direct taxes cover the income tax, charges from vehicles and driving licenses, institutions' tax, property tax and inheritance tax. Indirect taxes cover customs tax, Bank and insurance operations tax and value added tax.

With respect to the above definitions, the total tax revenues have increased from 408.0 million TL to 25,100,925.4 million TL at current prices between 1977 and 1997 (Table-3.2). At the same time, they have shown a 314.5% rise at constant prices from 408.0 million TL to 1,691.3 million TL during the same period (Table-3.1).

Due to the rise in tax revenues, the share of tax revenues has grown from 10.7% to 21.3% in GNP. This shows to us that the tax revenues have doubled. At the same period, the share of direct taxes have shown a 233.3% rise from 3.6% to 12.0% with respect to GNP. On the other hand, indirect tax ratio to GNP has grown from 7.1 to 9.3%. In the specified period the share of direct Taxes in GNP have followed a faster rise when compared to the share of indirect taxes. Together with these, the rate of increase of direct taxes has been within the growth limits in GNP (Table-3.3). Average share of total tax revenues in total local revenues has been 76.7% for the period. Average share of direct taxes in total local revenues has been 37.1%, whereas that of indirect taxes has been 39.6% for the period 1977-1997.

For establishing a modern and just tax structure, which will cover the whole economy, the Value Added Tax (VAT) law has been put in operation in 1996. By the enactment of this law, widening the coverage of taxes, reducing the losses in tax revenues and providing justice in the distribution of taxes have been targeted. There have been significant losses in the tax revenues in 1996 because of rearrangements in the other taxes and funds and also because the people were unfamiliar with VAT. But the positive results of the implementation of VAT law have affected the whole tax structure of the TRNC in 1997. The share of tax revenues in GNP has increased to 21.3% in

1997 from 17.9% in 1996, which means a 19.0% increase in tax revenues (Table-3.3). When we consider the development in indirect taxes, we see that the share of indirect taxes in GNP has increased to 9.3% in 1997 from 7.6% in 1996 indicating a total increase of 22.4% (Table-3.3).

2.2.2 Other Income

The budget of TRNC includes some revenues, which can not be classified as taxes. These include revenues from fees (e.g. import export certificate fee, passport fee and court fee), revenues from the services provided (e.g. postal charges, fines and confiscation), revenues from public economic enterprises (mainly from Cypruvex), revenues from treasury property rents and various revenues (such as contributions of the state personnel). For more detail about the coverage of Other Income, previous chapter can be seen.

Other Income (Revenues) show increases from 219.7 million TL to 6,551,492.3 million TL at current prices. At the same time, these revenues have grown from 219.7 million TL in 1977 to 441.5 million TL in 1997 at constant prices. This means a total of 101.0% and 3.5% yearly increase, with respect to 1977 prices. Even though there have been rises in revenues at constant prices, their share in GNP has shown a steady decrease from 5.8% to 5.5% in the specified period. Average share of other income in total local revenues has been 21.4% for the period 1977-1997.

2.2.3 Fund Revenues

As mentioned in the previous chapter, the law passed in 1992 and the statutes applied in 1993, have allowed the budget to use funds as revenues, starting from 1994's budget. Hence 50 % of:

- Foreign exchange stability fund,
- Price stability fund, and
- 10% of Tourism encouragement fund

(To be transferred to state budget), are used as revenues.

For more detailed information about the types of fund revenues used, previous chapter can be seen.

A steady decrease in fund revenues has followed from the year of its implementation, 1994, to 1997. Fund revenues have decreased from 377.6 million TL in 1994 to 184.1 million TL in 1997 at 1977 constant prices (Table-3.2). This is equivalent to a total decrease of 51.2% during the period 1994-1997. These values show to us that the fund revenues have followed a 23.9% yearly average decrease in the specified period. Average share of fund revenues in total local revenues has been 1.9% for the period 1977-1997.

The share of Fund revenues in GNP has decreased from 5.2% in 1994 to 2.3% in 1997 showing a decrease of 56.6% in total (Table-3.3). This result indicates a yearly average decrease of 27.2% in the share of fund revenues in GNP. The decline in the fund revenues is mainly due to the continuous losses of "Cypruvex Public Enterprises". [33]

On one hand, it seems economically logical to have such funds, as they will be used for improving the infrastructure, for the protection of producers and for the promotion of tourism. But on the other hand, it is well known that these funds are not used for fulfilling the objectives they are implemented for, but are used for financing the current expenditures or budget deficits.

Local revenues of the TRNC have shown a changing structure in their composition. Share of direct taxes for the years 1977 and 1981 has not even reached to the 30.0% of total local revenues whereas indirect taxes have been realized over 40.0% during the same period (Table-3.5). Especially between the years 1981 and 1986, the share of direct taxes has grown so fast, reaching 43.5 % in 1986. As a result of rises in the share of direct taxes, the composition of budget revenues has changed. On one hand, there has been a decrease in indirect taxes from 43.4% in 1977 to 31.8% in 1997 while on the other hand, other income has steadily decreased from 35.0% in 1977 to 19.1% in 1997.

---

[33] KKTC Başbakanlık, **DPÖ, 1998 GEÇİŞ YILI PROGRAMI**, 1997 Lefkoşa, p.39.

Table-3.5 Total Local Revenues (At 1977 prices, Million TL)

Years	Direct Taxes	%	Indirect Taxes	%	Total Tax Revenues	%	Other Income	%	Fund Revenues	%	Total Revenues
1977	135.9	21.7	272.1	43.3	408.0	65.0	219.7	35.0	-	-	627.7
1978	140.0	23.0	316.4	51.8	456.4	74.8	153.9	25.2	-	-	610.3
1979	139.5	22.2	264.1	42.1	403.6	64.3	224.0	35.7	-	-	627.6
1980	108.4	22.5	230.1	47.7	338.5	70.2	144.0	29.8	-	-	482.5
1981	158.6	28.7	256.8	46.5	415.4	75.2	137.4	24.8	-	-	552.8
1982	193.9	33.2	252.6	43.3	446.5	76.5	136.9	23.5	-	-	583.4
1983	273.3	33.5	361.3	44.3	634.6	77.8	180.9	22.2	-	-	815.5
1984	319.9	38.0	356.2	42.4	676.1	80.4	164.9	19.6	-	-	841.0
1985	344.1	40.0	359.9	41.8	704.0	81.8	156.8	18.2	-	-	860.8
1986	395.5	43.6	322.8	35.6	718.3	79.2	189.7	20.8	-	-	908.0
1987	515.7	44.4	432.9	37.3	948.6	81.7	212.1	18.2	-	-	1,160.7
1988	591.1	43.2	544.8	39.9	1,135.9	83.1	231.3	16.9	-	-	1,367.2
1989	612.6	43.1	570.0	40.1	1,182.6	83.2	237.7	16.8	-	-	1,420.3
1990	748.8	42.6	746.6	42.4	1,495.4	85.0	264.2	15.0	-	-	1,759.6
1991	707.7	46.7	529.5	34.9	1,237.2	81.6	274.1	18.4	-	-	1,516.3
1992	692.9	44.8	593.0	38.3	1,285.9	83.1	261.5	16.9	-	-	1,547.4
1993	791.4	43.1	722.6	39.3	1,514.0	82.4	323.1	17.6	-	-	1,837.1
1994	795.1	38.2	576.5	27.7	1,371.6	65.9	332.3	16.0	377.6	18.1	2,081.5
1995	776.1	43.3	538.8	30.0	1,314.9	73.3	341.1	19.0	138.2	7.7	1,794.2
1996	786.8	42.0	585.1	31.2	1,371.9	73.2	378.8	20.2	123.5	6.6	1,874.2
1997	954.2	41.2	737.1	31.8	1,691.3	73.0	441.5	19.1	184.1	7.9	2,316.9

--Shares are calculated by using the statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-19, 1998 Lefkoşa, pp.28,29.

In general, the composition of the revenues shows to us that the burden of tax is increasing. In 1977, the share of total tax revenues in total local revenues was only 65.0% whereas this has reached 73.0% in 1997.

However, in spite of this, even while the burden of the tax is increasing, the share of the tax revenues in national income has not shown a proportionate increase with respect to the increase in the tax burden (Table-3.3). It is a general tendency to see that the share of tax increases in national income together with economic and social developments. The share of tax revenues has been 15.4% on the average for the period 1977-1997 in GNP. The main reason, which causes the burden of tax to be low, is the fact that the share of direct tax is only 7.7% on the average for the period 1977-1997 in GNP. This result shows to us that, revenues other than wages and salaries paid by

the state, are not taxed efficiently and effectively. In other words, there are some incomes, which are not taxed properly or not taxed at all.
When we consider the fact that propensity to invest is low in the TRNC, we can also see those revenues, which are underrated and not channelled to investments sufficiently. In other words, fiscal evasions are not turned into investments, and also their contribution to increase the capital stock is limited. The reason for this can be explained as the negative climate for investments in the country due to high costs and high interest rates, which will be discussed in following sections while examining crowding out. However, the answer to this lies in the above mentioned measures that need to be taken at once. Due to negative climate for investments in the country, the under-taxed or not taxed revenues are not channelled to investments, they outflow creating a negative effect on capital stock in the country.

In the light of the statistics, budget revenues have not been increased to the desired level in an efficient way. At this stage, it is obvious that the revenue side of fiscal policies have not been effective enough. At this stage, improving the VAT application and allowing funds to flow to the budget, as revenue might be a short run measure for changing the structure of local revenues.

2.3 Foreign Aid and Loans, the Budget Deficit

When the revenues of the budget do not counterbalance the expenditures, it is said that there is a budget deficit. When budget deficits occur, governments should find ways and methods for financing the deficits. As it can be seen from Tables 3.1, 3.2, 3.3 and from sections 2.1 and 2.2 of this chapter, budget expenditures exceed the budget revenues in the case of the TRNC. The shares of total budget expenditures and total budget revenues in GNP are listed in Table-3.6 for the period 1977-1997. Also, composition of budget expenditures and revenues can be seen in Graphs 3.1a and 3.1b.
In this section, the historical development of the budget deficits in the TRNC, the methods of deficit financing in theory briefly, and the way the deficits are

financed in the TRNC will be analysed. After analysing the structure of Borrowing and Aids in the TRNC, conclusions will be drawn.

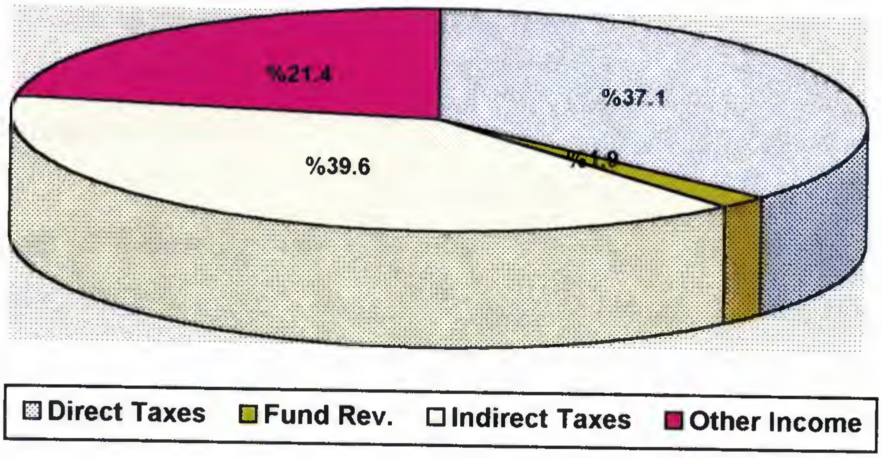
Table-3.6 Budget Revenues and Expenditures Compared (Shares in GNP)			
Years	**Revenues**	**Expenditures**	**Deficit**
1977	16.5	31.2	14.7
1978	15.1	27.2	12.1
1979	14.9	28.1	13.2
1980	11.4	24.0	12.6
1981	14.0	29.4	15.4
1982	13.4	28.4	15.0
1983	18.4	34.6	16.2
1984	17.8	36.5	18.7
1985	16.9	36.1	19.2
1986	17.0	36.1	19.1
1987	20.4	36.7	16.3
1988	22.5	31.0	8.5
1989	21.5	28.3	6.8
1990	25.2	33.9	8.7
1991	23.0	39.2	16.2
1992	21.7	33.9	12.2
1993	24.3	36.0	11.7
1994	28.6	37.8	9.2
1995	24.0	38.8	14.8
1996	24.4	38.3	13.9
1997	29.1	42.4	13.3

--Prepared using the statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-20, 1998 Lefkoşa, p.31.

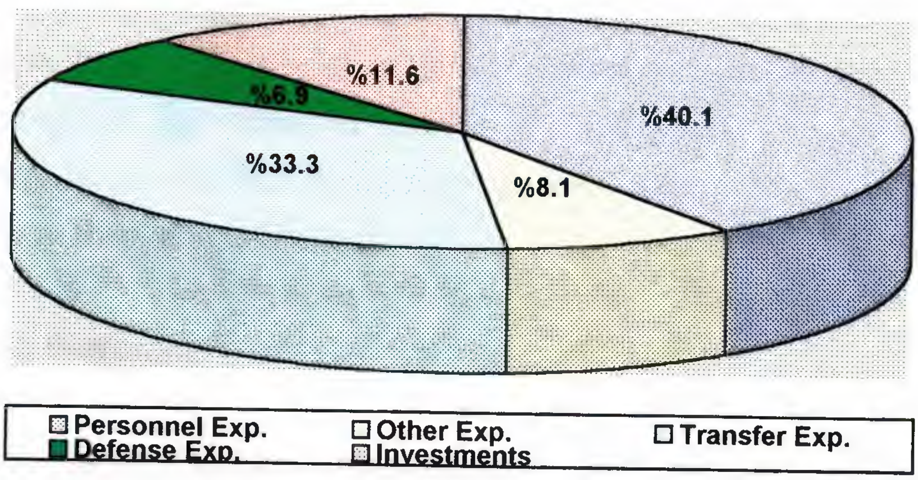
2.3.1 Deficit Financing in Theory

When the revenues of the budget do not counterbalance the expenditures, the state should find ways and methods of financing the deficit. Foreign aid and borrowings are elements of the budget for financing the deficit. The methods and the techniques used in financing the deficit may create financial and economical disturbances. Developing nations are more sensitive to the effects of these disturbances, as they do not have too many alternatives for financing their deficits.

Graph-3.1a Budget Revenues of the TRNC



Graph-3.1b Budget Expenditures of the TRNC



-- Period's average shares are plotted.

In theory, there are three main methods which, the states utilise for transferring funds to finance deficits. These are:

i- Debt-Financed Deficit:

In this method of financing, the treasury finances its deficits by borrowing from the public. This is done through the sale of treasury bills/bonds in the open market to the public. This allows the public sector to make more use of private sectors funds.

ii- Money-Financed Deficit:

The second method that states use to finance their deficits is by monetizing the debt. When the treasury borrows from the Central Bank for financing its deficits, it engages in money financing. The distinction between money and debt financing can be further clarified by noting that treasury sales of securities to the Central Bank are referred to as monetizing the debt, meaning that the Central Bank creates money (High-powered) to finance the debt purchase. In other words, there is a monetary expansion (Seigniorage). Since the stock of high-powered money is an important macroeconomic variable, there is an essential distinction between selling debt to the public and selling it to the Central Bank.[34]

iii- Foreign Borrowing:

When the state faces difficulties in utilising the domestic sources, it searches for funds in abroad. Depending on its credibility in international markets, state tries to secure the inflow of fund to the country for financing its deficits. Thus, this time the claims are not transferred to the private sector or to the Central Bank but to other nations.

---

[34] Dornbush and Fischer, op.cit., p.576

2.3.2 Deficit Financing in the TRNC

When we analyse the foreign aid and borrowings part of the budget, it can be seen that, not many of the stated alternatives are applicable in the economy of the TRNC.

-Firstly, there is not a well developed financial market, by which the state can issue securities and go into debt financing.

-Secondly, the state does not have full control on the money supply due to the fact that it can not print its own money. Turkish Lira (TL) is used as legal tender.

-Thirdly, since the TRNC is not recognised, it can not really have access to the international markets and find sources. All these drawbacks leave the TRNC only with limited ways for financing its deficits.

These ways are:

i- Domestic Borrowing:

It is directly done through the Central Bank of the TRNC. It is the only source for the state to borrow domestically.

ii- Aid:

Most of the aid is coming from the Republic of Turkey. They are to finance the master plans and specific projects of the country, such as highways, telecommunication, irrigation and schooling. Other aid comes from United Nations, which is too low when compared to the aid flowing from Turkey.

iii- Foreign Borrowings:

The only source of inflow to the country under foreign borrowing is flowing from Turkey. No other nations lend to the state of TRNC. It is also believed that the money borrowed from Turkey has never been paid back. Therefore, it is like an aid.

Budget deficits, which are great burden on the economy, are financed by the aids obtained from the Republic of Turkey and by borrowings.

2.3.3 Evolution of Budget Deficits in the TRNC

The need for borrowing has decreased from 364.8 million TL in 1977 to 235.5 million TL in 1997 at constant prices. This shows a total decrease of 34.4% and 2.2% yearly average (Table-3.2). On the other hand, the share of borrowings in GNP has decreased from 9.6% in 1977 to 2.9% in 1997. These shares in GNP amount to a decrease of 69.9% in total and 6.0% yearly average in GNP within the period 1977-1997. This decrease is related with the faster growth of revenues relative to the growth of expenditures.

In the period 1989-1992, borrowing need of the state has been increased from 175.6 million TL in 1989 to 581.0 million TL in 1992 at constant prices. At current prices, this increase has been from 24,201.3 million TL to 314,162.1 million TL (Table-3.1). According to these results, during the period 1989-1992, the borrowing need of the state has increased 230.9% in total, and 39.9% yearly average (Table-3.2). The high need for borrowing, or in other words, high volume of budget deficit, during the period 1989-1992 is due to the crisis that the TRNC has suffered in 1990 and 1991. These crises namely are the "Gulf war crises", "Polypeck or Asil Nadir crisis", "Banks crises", drought, and recession. The share of borrowing in GNP during the period has been an increase from 2.7% in 1989 to 8.5% in 1992. When the average share for ten years periods are considered, it is seen that the share of borrowing for the period 1977-1987 has realized as 9.6% whereas this share for the period 1987-1997 has decreased to 7.0%.

Table-3.7 Budget Deficits With Regard to Years
(At Current Prices, Million TL)

Years	Budget Deficit	Share in GNP (%)
1977	558.4	14.7
1978	635.6	12.1
1979	1,126.4	13.2
1980	2,217.2	12.6
1981	3,769.9	15.4
1982	5,131.1	15.0
1983	7,635.4	16.2
1984	13,804.9	18.7
1985	24,292.7	19.2
1986	37,193.0	19.1
1987	47,020.3	16.3
1988	41,518.9	8.5
1989	61,394.2	6.8
1990	134,419.9	8.7
1991	369,193.9	16.2
1992	492,377.4	12.2
1993	814,772.9	11.7
1994	1,511,954.0	9.2
1995	5,192,007.2	14.8
1996	8,852,231.7	13.9
1997	15,775,772.1	13.3

--Prepared Using the Statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-20, 1998 Lefkoşa, p.31.

The shares of borrowing in GNP, or in other words the budget deficit, have been outstandingly high in the years 1991 and 1995. The share of borrowing in GNP has been 11.2% in 1991 and 11.1% in 1995. Note that both years are the years that TRNC was subjected to crises. For 1991, the crises mentioned above and for 1995 the "money crisis" when Turkey had to devaluate the Turkish Lira. During both of the crisis periods, in spite of the reduction in the revenues of the state, government was not able to take measures for reducing or limiting the expenditures. This has been effective on the realisation of high volume budget deficits in both of the crisis periods.

Evolution of budget deficits together with the revenues and expenditures can be seen in Graph-3.2a and Graph-3.2b. Also, Table-3.7 gives a list of budget deficits at current prices together with the shares in GNP as regards to budget years.

2.3.4 Foreign Aid and Loans

Foreign aid and Loans are part of the budget for financing deficits and investments. This part of the budget is as important as the other parts of the budget since it has significant effects on the economy.

The Foreign aid and loans part of the budget of the TRNC is composed of two sub-elements. These are:

i- Foreign Aid – consists of two parts:

a) Aid from Turkey

b) Other aids

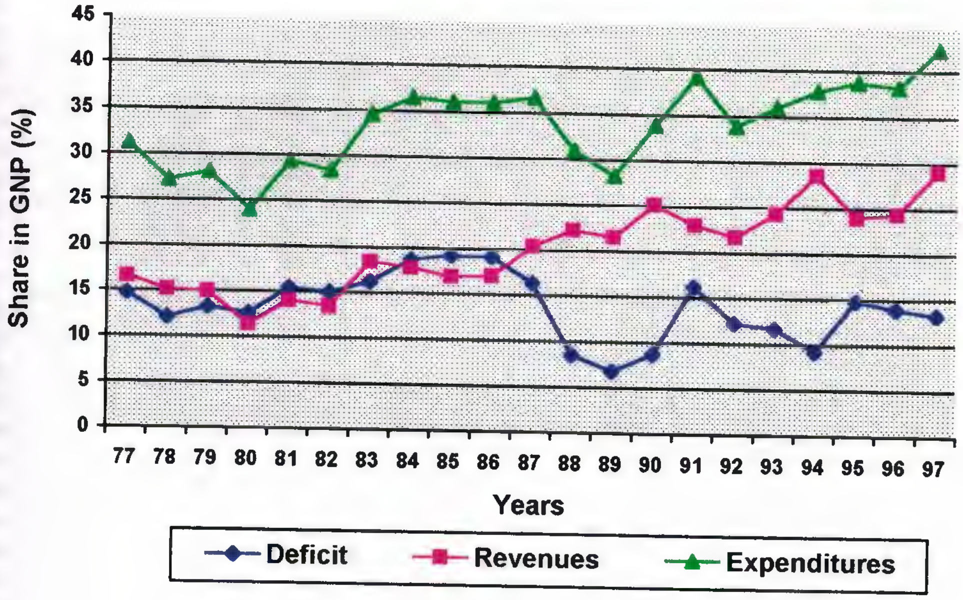
ii- Loans – consist of two parts:

a) Internal (domestic) loans

b) Foreign loans

The aid and credits from Turkey have been used for financing the budget deficit and part of the current expenditures until 1980. In spite of the fact that these aid and credits were for financing part of current expenditures and the investments, almost 90% of the budget deficit has been financed in this way. The T.C. Ziraat Bank to the treasury gave most of the domestic borrowing. T.C. Ziraat Bank has acted as a Central Bank since the TRNC did not have a Central Bank until 1983. After the establishment of the Central Bank in 1983, the treasury has started to use more domestic sources for financing the deficits. This has caused a change in the structural composition of deficit financing.

Graph-3.2a Evolution of the Budget of theTRNC



Graph-3.2b Evolution of the Budget of TRNC

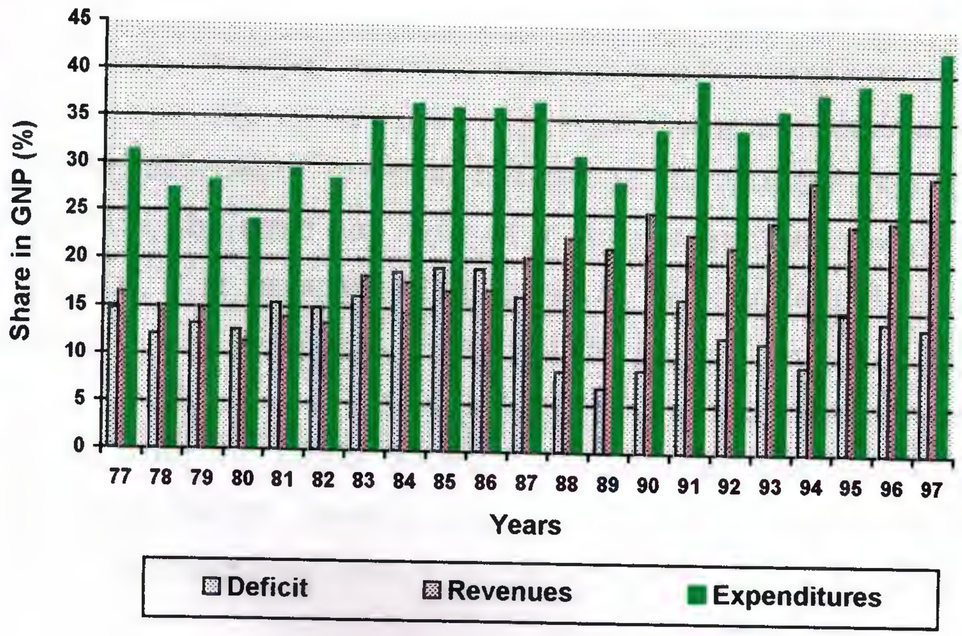


Table-3.8 Foreign Aid and Loans

(At 1977 prices, Million TL)

Years	Foreign Aid				Loans			
	Turkey	%	Other Aids	%	Domestic	%	Foreign	%
1977	193.6	-	-	0	88.8	16	276.0	49
1978	168.3	35	39.0	8	57.0	11	220.7	46
1979	185.2	35	25.2	5	17.2	3	330.1	59
1980	146.9	33	9.5	2	7.3	1	373.3	69
1981	275.7	46	3.9	1	-	-	324.4	53
1982	286.2	44	4.8	1	-	-	365.6	55
1983	364.9	51	4.4	1	-	-	351.4	48
1984	444.9	50	3.4	1	-	-	433.9	49
1985	418.5	44	53.5	5	150.3	15	350.4	36
1986	319.3	32	79.3	8	125.1	12	491.1	48
1987	392.1	43	117.2	12	218.6	23	196.6	22
1988	193.5	38	83.6	16	242.8	46	-	-
1989	241.6	54	28.2	6	175.6	40	-	-
1990	220.8	37	8.6	1	331.5	54	45.1	8
1991	318.9	30	11.4	1	455.6	42	286.8	27
1992	263.3	30	2.6	1	418.4	48	184.5	21
1993	317.4	35	4.8	1	562.5	63	1.2	0.1
1994	272.3	41	4.7	1	385.7	58	-	-
1995	265.8	24	8.7	1	826.2	75	-	-
1996	738.6	69	12.9	1	256.6	24	60.3	6
1977	820.1	77	7.4	1	235.5	22	-	-

--The shares are calculated by using the statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-19, 1998 Lefkoşa, pp.29-30.

The share of domestic borrowing was 15.0% in 1985 whereas it has reached 75% by 1997 (Table-3.7). Noting the fact that the share of foreign borrowing has decreased steadily, especially after 1987, when the protocol was signed between Özal and Eroğlu governments of Turkey and the TRNC respectively. In the protocol signed in 1987, it is stated that the aids would be totally allotted to investment projects, but not to the current expenditures. After this protocol, the state has inclined to the domestic borrowing for financing the deficits. It is important that most of the domestic borrowings of the treasury are from the funds account at the Central Bank and from the funds accounts at the other banks. More importantly, the treasury has been borrowing from the funds revenues account which is discussed in section 2.2.3 of this chapter, namely, price stability, foreign exchange stability and tourism encouragement funds which were to be used for other mentioned purposes.

The other important issue is the relationship between the aid coming from Turkey and the fund allotted to investments throughout the years. We can see that the increase in the aid coming from Turkey leads to increases in investments verifying that the aid is used in financing the investments. On the other hand, when there were decreases in the aid, such as in 1988, there have been decreases in the investments (Table-3.1). This is an indication that the TRNC is highly dependent on the aid coming from Turkey for realising its investments. This has become more noticeable after the 1987 protocol between Özal and Eroğlu governments.

The government fund and price policy has two side effects on the private sector. Price increases as a result of the funds laid on goods, and leads to a decrease in the spending and purchasing power of the individuals creating dullness in the domestic market. The second effect is, the mark-ups which are included in the price of goods that decrease the private sectors disposable income that can be spend or saved, and tighten its savings. These effects result in crowding out of the private sector. The crowding out effect will be discussed in detail while examining the effects of budget deficits on the economy, in Chapter IV.

Recall from Chapter I that, according to neo-classical model, tax financing, when government initiates a project, or borrowing, means the removal of resources from the private sector (crowding out); and the demand of government for credit, means a rise in the interest rate.[35] In the case of the TRNC, funds laid on goods and services are a kind of tax financing while treasury borrows from the funds accounts at the Central Bank and at other banks. Therefore, in the case of the TRNC, for financing the budget deficits or for contributing to some projects through fund revenues, neo-classical approach in theory holds.

[35] Harvey, op.cit., p.467.

However, we should not look at the case from one point of view. In today's world even the most powerful states face deficits and debts. If the state can easily borrow from domestic or international markets and invest these funds into profitable areas and turns them into productive investments, not borrowing will be a wrong economical decision. Related with these, the state should be careful on the following conditions when it is engaged in borrowing:

- The state should not borrow at the expense of dissolving the available fund sources that are for the of private sector use, which could be converted to productive investments.

- The state should use the borrowed funds for profitable investments, or at least for investments that will create employment or will provide social profit and social utility to the nation.

- Credit conditions that should be adapted must be in harmony with the aim of the usage and productivity principle.

The share of the aid from Turkey has not changed for years, but has reached its peak with 75.0% in 1997 (Table-3.7). This is because of the flow of the first part of the credit as regards to the 250 Million U.S. Dollars worth credit agreement with Turkey on January 1997. This credit agreement is in accordance with the Economic Co-operation Protocol, which was signed by Eroğlu and Erbakan governments of the TRNC and Turkey respectively, on 3rd January 1997. It is stated in this protocol that Turkey will provide the necessary financial and technical support for realising the structural change and for reaching an economic stability that the economy needs. Within the frame of the credit agreement, the flow of credit started after the second half of 1997.

Foreign Aid Loans which, occur as the financing need of the budget of the TRNC, has realized as 13.3% of GNP in 1997, 10.4% of which is used for defence expenditures, investment projects and for meeting the retirement payments in accordance with the protocol.

Moreover, it is stated in the protocol that the retirement payments for the public employees will be taken out of the budget by a system which, will be complementary element of "single social security" system. In this way, the goal of reducing the burden of retirement premiums and salaries targeted. Therefore, there is an urgent need for completing the preparations and implementing the new system as described in section 2.1 of this Chapter.

Aids from sources other than Turkey have been from Untied Nations and from some of the Arab countries. Their shares have been very small compared to the aid from Turkey. This is another indication that the deficit financing has been highly dependent on Turkey.

3. Conclusion

The TRNC is experiencing structural problems accumulated throughout the years, starting from its establishment. Although there are difficulties due to being an unrecognised country, the main problem seems to be the high share of the public sector in the economy and being unproductive in general. Free market economy has not yet been institutionalised and the state is still taking part in the economy by intervening the market through the public enterprises like TÜK, Cypruvex, Dairy Products Institution, ETİ and performing services in the banking and insurance sectors.

The structural problems lead to the budget deficits in the country. Current expenditures, especially personnel expenditures and transfer payments are the main elements that create the budget deficits. There is a need for controlling the budget deficits, and this is possible by taking measures for increasing the revenues and limiting the expenditures of the state as a short run measure, while restructuring.

While working for improving the budget expenditures on one hand, measures for reducing the personnel and transfer expenditures must be taken on the other hand. Restricting the personnel salaries and reducing the number of public employees will create a social impact. But public services can be sustained efficiently by considering the productivity principles during the applications and by shifting the personnel to the convenient employment areas. Taking the retirement premiums and salaries out of the budget by a system, which will be done in accordance with the economic co-operation protocol with Turkey, will help in reducing the budget deficits, but application must not be delayed.

Besides the personnel and transfer expenditures, public economic enterprises are a big problem as they cause budget deficits too. Borrowing finances their losses.

Imposition of funds on goods and services and domestic borrowing of the treasury from funds accounts is not only creating budget deficits, but also leads to crowding out of the private sector. This result holds with the neo-classical approach in theory as mentioned in Chapter I.

The share of budget expenditures in GNP is average 35.0 % after 1990's while that of budget revenues is 23.0%. When we consider the tax revenues, which are the main fiscal policy tool as, mentioned in Chapter II, the difference becomes larger. The average share of tax revenues after 1990' is 19.5%.

This share in the OECD countries is 29.0%.[36] Therefore, there is an urgent need for a tax reform in the TRNC, which will establish a modern tax structure that will cover the whole economy and by which, the coverage of taxation will be expanded, missing taxes will be reduced and the distribution of taxation will be just. Also, the Tax Management of the state needs to be improved by introducing a more efficient tax assessment and collection system and by increasing the frequency of controls, for reaching the desired objective. It is believed that by the implementation of Value Added Tax (VAT) law, the defects in the present system would be recovered. In spite of the fact that there have been some positive effects of VAT applications from the revenue aspect, it has not been sufficient neither for restructuring the economy, nor for restructuring the tax system. The government authorities have seen VAT as a new source for increasing the revenues of the state in order to meet the salaries of the government employees and for financing the budget deficits. But the fact that VAT could only be one of the economical measures that should be taken for restructuring the economy and for obtaining the best result, has been ignored till today.

Coming to the effect of borrowing on households, again the neo-classical approach in the theory holds, as it is mentioned in Chapter I, it is believed that the debt would eventually paid off. In the case of the TRNC, it is believed

[36] İktisadi Araştırmalar Vakfı, op.cit., p.59.

that the budget deficits would eventually paid off by the aids from Turkey. Therefore, there is not direct effect of budget deficits on the households.

The economic co-operation protocol signed with Turkey is very important. Three basic objectives of the protocol are:

i) Overcoming the bottle necks in the economy
ii) Creating a highly competitive economy
iii) Deepening the relationship with Turkey,
Which means economical integration.

These three basic objectives form the solutions of the economic problems of the TRNC, and achieving these goals will remove most of the economic problems of the TRNC.

IV. EFFECTS OF CONTINUOUS BUDGET DEFICITS ON THE ECONOMY

1. Introduction

One of the most important problems that economies face especially after the Second World War is increasing budget deficits and/or public deficits. With the Keynes's General Theory, by which governments started to intervene in the economy systematically, the result of tax revenues remaining insufficient to meet the increased public expenditures, became evident. In recent years, the increase in public expenditures has created budget deficits in many countries. Budget deficits are reasons for the concentration of public deficits. Because, increased public expenditures are financed either by taxes or by borrowing, in an economy. Increased budget deficits occur in case of meeting the increased public expenditures by borrowing instead of covering it by taxes. Thus, increased budget deficits and increased public borrowings, are main causes of economic instability such as inflation.

Financing of budget deficits plays an important role on economic policies related to employment, inflation and growth. Depending on the source of financing of the budget deficits, savings, investments, distribution of income and price changes may be influenced. Of course, financing of the deficits can be realized by using the fiscal policy tools that the state has. For example, tax revenues may be used as mentioned in Chapter II, government bonds may be sold to individuals or firms for obtaining income or new money may be created. When government bonds are sold to individuals and firms that are located in the country, this is considered to be domestic borrowing and the owners of the bonds may feel richer due to the interest income of the bonds. In this case, they may tend to increase their consumption instead of tending to increase their savings, or the reverse may happen; bond owners, thinking that their future taxes may increase due to a rise in borrowing or inflation, may tend to increase their savings.

On the other hand, if the Central Bank buys the bonds instead of individuals and firms, in this case money supply will increase and inflation may tend to increase again.

If the government bonds are sold to individuals and firms abroad, this means that country's sources are transferred to outside when payback period comes.

Experience of Turkey in 1980's is a good example for explaining all that have been mentioned above in this section. After 1980, financing of budget deficits from the Central Bank's resources (borrowing from the Central Bank) has been abandoned because of created inflationary effects, in Turkey.[37] Because of this policy change, importance is attached to domestic borrowing for financing the budget deficits in Turkey. For this purpose, bonds are sold through the banking sector in Turkey after 1985. But this has meant the transfer of funds from the commercial banks to the public sector of Turkey. This is accepted as most important evidence of the financial crowding out event experienced in the private sector of the Republic of Turkey.[38] On the other hand, domestic borrowing through the issuance of bonds caused instability in the economy of Turkey since the interest burden has created larger public expenditures that have led to larger budget deficit. Also, increased consumption tendencies of the bond holders due to the interest income has contributed to the inflationary pressure in Turkey at that time.

There are many reasons for opposing the continuous budget deficits. Increases in the interest rates, public's laying hands on the high proportion of the present savings and distorting effects created on the foreign trade sector are some of the reasons. But there is not a common judgement about scale and timing of the danger that will come due to the budget deficits.

---

[37] Gönül, op.cit., p.98.
[38] Ibid., p.99

There are short-run and long run effects of budget deficits that should be considered. The change in public borrowings in the short-run is less effective on the saving decisions of the households and investment decisions of the investors. In the short-run, some deviations on the potential of the economy are observable. According to most economists, continuous budget deficits create more serious results in the long run relative to the effects created in the short-run. While short-run analysis verifies that there is a correlation between the budget deficits and consumption and saving, different tendencies in real capital stocks and in production occur in long-run analysis.

In the long run, slowing down in private sector investments creates a negative effect on an economy. At he same time, both the real capital stocks' growth and the use of new production techniques slow down. This in return leads to a slow down in both the productivity rate and GNP growth rate.[39]

Discussions for explaining the economic effects of financing the budget deficits are mainly done by considering the three approaches, Neo-classical approach, Ricardian approach and Keynesian approach, which are discussed in Chapter I.

In this chapter, the effects of budget deficits on the interest rates, savings and investments will be examined. Also it will be analysed whether budget deficits create crowding out effect on the economy of the TRNC or not.

1.1 Idea of Crowding Out and the Role of Government

Governments call on two main macroeconomic policy tools, fiscal and monetary policies, for trying to keep the economy growing at a reasonable level with low inflation. Fiscal policy has its initial impact on goods market and monetary policy has its initial impact mainly on assets market. But because the goods and assets markets are closely interconnected, both

[39] Gönül, op.cit., p.55.

monetary and fiscal policies have effects on both the level of output and interest rates.

Crowding out occurs when expansionary fiscal policy causes interest rates to rise, thereby reducing private spending, particularly investment.[40] Aggregate demand is directly affected by fiscal policy. An increase in government spending increases aggregate demand, tending to raise output. So far, an economy with prices given, in which output is below the full employment level is assumed. But when fully employed economies are talked about, crowding out becomes a much more realistic possibility because firms can not then increase output. In such conditions an increase in demand will lead to an increase in price level rather than an increase in output.

However, in an economy with unemployed resources there will not be a full crowding out.[41] A fiscal expansion will raise interest rates, but income will also rise. Crowding out is therefore a matter of degree. The increase in aggregate demand raises income and with the rise in income, the level of saving increases. This expansion in saving, in turn, makes it possible to finance a larger budget deficit without completely displacing private spending. Fiscal policy is more effective, the smaller are the induced changes in interest rates and the smaller is the response of investment to the interest rate changes.[42] The extend of crowding out is an important issue in assessing the usefulness and desirability of fiscal policy as a tool of stabilisation policy.

Monetary policy affects the economy in the first instant by changing the interest rate, and then by affecting the aggregate demand. Increases in the money supply reduces the interest rate and, increases investment spending and aggregate demand, thus increasing the equilibrium output. Fiscal expansion, except extreme circumstances, still leads to an income expansion.

---

[40] Dornbush and Fischer, op.cit., p.131
[41] Ibid., p.133
[42] Ibid., p.145

However, the rise in the interest rates that comes about through the increase in money demand caused by higher income, dampens the expansion.

The question of monetary-fiscal policy mix arises because expansionary monetary policy reduces the interest rate while expansionary fiscal policy increases the interest rate. Accordingly, expansionary fiscal policy increases output while reducing the investment; expansionary monetary policy increases output and the level of investment.

Governments have to choose the mix in accordance with their objectives for economic growth, or increasing consumption, or from the viewpoint of their beliefs about the desirable size of the government.

2. Effect of Budget Deficits on Interest Rates

As mentioned before, if budget deficits are financed by creating new money in a ratio greater than the growth rate of the economy, inflationary period starts where the nominal interest rates increase. In an economy that is not in inflationary period, in the cases where the budget deficit is continuous and for financing the deficit additional money is not printed, real interest rate will increase to reflect each increase in the borrowing.

It is obvious that financing of the current and anticipated budget deficits results in high interest rates and crowds out the private sector in the market since private markets are highly sensitive to the increase in the credit interest rates. While open expenditures crowd out the private sector from investments, funds obtained are not generally used for investments. This situation leads to a slow down of growth of the economy, which is not inflationary.

Large budget deficits occur as a result of high public expenditures that creates inflation at the expansion periods where the economy is encouraged. For balancing the excess encouragement that is formed as a result of the budget deficit and for preventing inflation, high interest rates and other fiscal and monetary policies are used. But on the other hand, high interest rates make the reduction of the budget deficits difficult.

Of course budget deficits are harmful for the economy. There might not be important reactive effects due to the budget deficits in the short-run, but the harms due to the deficit are generally long-term and indirect. Budget deficits may decrease investments, may discourage exports and may slow down the growth in the long run. Because of the short-term political interests, administration in charge may be reluctant to reduce the budget deficits, but the burden remains on the shoulders of younger generations.

On the other hand, increasing interest rate due to the continuous budget deficits and due to the borrowing policy adopted for financing the deficit renders the bonds become attractive to the foreign investors. When the state needs cash currency, the interest rates of the bonds are increased. As a result of this tendency, exchange value of national currency increases. A rise in the exchange value of the money means that a tax is imposed on exports and import is promoted. Thus, an imbalance in foreign trade results.
Although empirical results show that there exist no considerable strong relationship between budget deficits and short-run interest rates; with large deficits and high interest rates, the relationship is considerable. [43]

It is even difficult to reduce the continuous budget deficits and they are taken to be an internal problem of a country. When budget deficits increase due to a rise in public deficits, more savings are transferred from the private sector to the public sector. Under these circumstances, it is right to pay higher interest rate to the bondholders, since these interest payments will turn back to the economy from macroeconomic aspect. The interest obtained by the bondholders will either be used for buying new bonds or will be invested on other investment tools. Such a development is regarded as

[43] Prof.Dr. Şevki Özbilen, op.cit., p.281.

positive as long as the gains acquired from interests are not transferred abroad.

The important problem here is, the problem of how and where to spend the funds obtained by the borrowing of the state. If these funds are spent for consumption instead of for investments, growth of the economy will be affected negatively and it will not be as large as if the money would remained in the hands of private sector.

In the long run, large budget deficits and high interest rates are creating serious problems from the aspects of economic stability and growth. This development affects domestic and even international economic conditions seriously. In spite of the fact that during the recession periods it is desired to increase the budget deficit for increasing the aggregate demand, it is obvious that it will create problems during the periods of improvement and high employment. It is a difficult measure that harms the economy that is given by the annual budget deficits. But in the long run, budget deficits may increase taxes, may slow down the growth rate and may lower the life standard. Therefore, special importance should be attached to the topic and decisions should be made with a long-run perspective as regards to the budget deficits.

2.1 The Case in the TRNC

In order to see if budget deficits have any of the effects, as explained in the previous section, on the economy of the TRNC, the economy of the TRNC has to be considered in more detail.

As mentioned in section 2.3 of Chapter III, it is a fact that there exist not many choices of the state of the TRNC for financing its budget deficits. The foreign aids and borrowing from Turkey mainly do it. Some domestic borrowing is done through the Central Bank from the funds accounts but these are mostly used in financing the current expenditure deficits.

Furthermore, it is known that borrowings from Turkey are more like aids than loans, since loans have specific pay back schedules.

Considering the fact that is mentioned above, since the loans from Turkey are not paid back, it is not possible for the interest rates to increase due to the back payment of the foreign borrowings. Therefore only the domestic borrowings that are done through the Central Bank can affect the interest rates in the TRNC. However, since the share of domestic borrowing in GNP is very low (2.7% in 1997), this does not play a role in the rise of the interest rates.

In spite of the fact that the TRNC does not have full control on money supply since the state can not print money (because the Turkish Lira is used as legal tender in the TRNC), financing budget deficits by the aids and borrowings from Turkey can be considered as creating new money for financing the budget deficits. Additional money from outside, that is , aids and borrowings from Turkey that are used for financing budget deficits, increases the aggregate demand causing expansion in the economy.[44]

Another fact to consider is that the Republic of Turkey finances almost all of the investment projects of the state in the form of aids or credits, which have never been paid back. Therefore, there are no budget deficits that are created as a result of inflationary public expenditures by which the investments or the economy is encouraged. So, there is no need to increase the interest rates for balancing the excess encouragement or for preventing the inflation.

On the other hand, since the financial market where the state can trade securities or bonds is not well developed, we can not say that interest rates increase because of the state buying bonds for cash currency.

---

[44] Çetin Uğural, **KKTC MALİ YAPISININ ANALİZİ VE ENFLASYON**, Lefkoşa 1993, p.97.

As a result, it is clear that interest rates in the TRNC are not influenced by the budget deficits, except the fact that there might be some effects due to the domestic borrowing, but that not being the main factor in the increase of the interest rates. But it will be useful to perform a simple rank correlation analysis in order to check if there is a significant relationship between budget deficits and interest rates in the TRNC. Rank correlation analysis can be seen in section 2.2.1 of this thesis.

The credit interest rates are changing between 120% and 160% since 1991. These rates are high enough to discourage investments.

Since the Turkish lira is used as a legal tender, high proportion of inflation is imported to the economy. The effect of economic, fiscal and exchange rate policies adopted in Turkey are reflected on the economy of the TRNC due to the use of Turkish Lira.[45] On the other hand, some resources from the private sector and public sector of the TRNC, are transferred to the public sector of Turkey as inflation tax due to the use of Turkish lira.[46] But it is believed that, these resources return back to the economy of the TRNC in the form of aids from Turkey to be used in realising the investment projects. Therefore, the aids from Turkey have a compensatory function for the inflation tax due to the use of Turkish lira.

As a result, we can say that high interest rates are mainly due to the imported inflation.

[45] İktisadi Araştırmalar Vakfı, op.cit., p.31.
[46] Çetin Uğural, op.cit., p.95.

2.1.1 Rank Correlation Analysis

Spearman Rank Correlation method will be used for analysing the relationship between the budget deficits and interest rates in the TRNC. Table below is prepared for this purpose. Average annual credit interest rates applied in the TRNC for the years of the period 1991-1997 are obtained from the Central Bank and the shares of budget deficits in GNP for the period is obtained from Table-3.6 of this thesis.

Data For Rank Correlation Analysis						
Years	**Credit Interest Rates (%) (C)**	**Share of B. Deficits inGNP (D)**	**Ranking of (C)**	**Ranking of (D)**	**d**	**d^2**
1991	75	16.2	7	1	6	36
1992	76	12.2	6	5	1	1
1993	80	11.7	5	6	-1	1
1994	197	9.2	1	7	-6	36
1995	125	14.8	2	2	0	0
1996	117	13.9	3	3	0	0
1997	99	13.3	4	4	0	0

Spearman Rank Correlation formula is given by; [47]

$$r_s = 1- \frac{6\sum_{i=1}^{n} d^2}{n(n^2-1)}$$

where, n= number of observations

and d= rank difference between the dual observations

$$= 1- \frac{6(74)}{7(7^2-1)} = -0.32$$

t-test for the Spearman rank correlation will be performed;

Hypothesis: Budget deficits have no effect on the interest rates; $H_0 : \rho = 0$

Alternative Hypothesis: $H_a : \rho \neq 0$

The coefficient ρ defines the real rank correlation where as r_s defines the rank correlation obtained from the analysis of the observations.

[47] Prof. Dr. Tümay Ertek, **EKONOMETRİYE GİRİŞ**, Beta Basım Yayım, 1996 Istanbul, p.179.

t value for r_s is calculated by using the formula;[48]

$$t = r_s \sqrt{\frac{n-2}{1-r_s^{\,2}}} \qquad t = -0.32 \sqrt{\frac{7-2}{1-(-0.32)^2}} = -0.75$$

for n-2=7-2= 5 degrees of freedom and $\alpha = 0.05$ level of significance,

$t_{\alpha/2}(5) = t_{.025}(5) = 2.571$ is the t-value to be compared.[49]

if $-t_{\alpha/2} < t < t_{\alpha/2}$, accept the hypothesis;

if $t \le -t_{\alpha/2}$ or $t \ge t_{\alpha/2}$, reject the hypothesis.

$(-t_{.025} = -2.571) < (t = -0.75) < (t_{.025} = 2.571)$

Therefore accept the hypothesis $H_0 : \rho = 0$

There is not a significant relationship between budget deficits and interest rates.

3. The Effect of Budget Deficits on Private Savings and Investments

When domestic borrowing finances the budget deficits, this is done at the expense of restricting the finance opportunities for the private sector. This phenomenon is known as crowding out in literature, and it occurs as in the form of crowding out in investments and financial crowding out.

Crowding out in investments restricts the use of real resources by the private sector, while financial crowding out restricts the use of financial resources by the private sector. Crowding out in investments means that public investments are expanded against the private sector investments, whereas financial crowding out means that large portion of the surpluses formed in the economy are transferred to the public sector; and because of this, usage of funds by the private sector is restricted.

---

[48] Ibid., p.180.
[49] Ibid., Table: 2, p.413

The Crowding out effect on private investments occurs depending on the area that the public sector investments are directed to. If the public sector investments are directed in an area so as not to be in competition with the private sector investments, it is difficult to suggest that the expansion in the public sector investments lead to crowding out of private investments. Under these conditions, public and private investments display a complementary character by which, the public sector investments will contribute to the realisation of private investments as well as contributing to their productivity and profitability (crowding in).

In literature, the crowding out issue is mostly discussed within the context of financial crowding out. It is difficult to define in detail and determine the dimensions of financial crowding out. Because, when the public deficits are financed by monetary expansion and/or by transferring fund from abroad, there will be restrictions in the potential fund volume that can be used by the private sector. But, the crowding out phenomena generally occurs when the public sector channels households' surplus to itself.

4. Do the Budget Deficits Create Crowding Out Effect in the TRNC?

Because of the budget deficits, an important portion of the private savings is used for financing the public sector, which is more than the portion that is used for investments. If domestic borrowing finances the deficits, this will restrict the credit opportunities of private sector investments.

To be able to see the situation in the TRNC, we need to examine the investment and savings balance in the TRNC and compare yearly public and private sector investments. Also, the developments in fixed capital investments and the developments in sectoral distribution of fixed capital investments should be analysed.

4.1 Balance of Investments and Savings

The portion of investments in the national income effects the development and life standard. The bigger is the portion of investments in the national income; the faster is the annual income increase. Because of this, determining the amount to be saved for production and how to use this amount out of the income obtained, is an important issue in the economic development.

Like in individual level, the part of the income, which is not consumed, is defined as saving in the national level, and this forms the domestic savings. Savings contribute to the capital accumulation and production increase, at the proportion that they are transferred to investments. This is why, the solutions related to spending forms like national income, consumption, saving and investments are significant in the economy. Investments- Savings balance explains the investment and savings relationship together with the source of investments.

Sources of investments that are realized in the TRNC, are domestic savings and external savings. At the beginning years, when higher portion of investments were financed by external savings only a smaller portion was financed by domestic savings. But in the development procedure of the country, this situation has been reversed and it has come to a situation where important portions of the investments are financed by domestic savings. While 454.8 Million TL of 596.6 Million total investments have been financed by external savings in 1977, at current prices, in 1997 only 6,584271.9 Million TL of 24,127,203.2 Million TL total investments have been financed by external savings (Table-4.1). According to these figures, while 76.2% of total investments are financed by external savings and 23.8% financed by domestic savings in 1977, share of domestic savings in financing the total investments has been increased to 72.7% and that of external savings has decreased to 27.3% in 1997. Although domestic savings deficit has been decreased during the period, external savings have still remained to be an important issue in setting the investments-savings balance.

Investments and savings are highly significant for economic development. Therefore, efforts are made for increasing the investments and savings. As a result of the policies applied and measures taken, there have been considerable increases in domestic savings and in fixed capital investments in real terms, within the period 1977-1997. Domestic savings have increased from 141.8 Million TL in 1977 to 895.6 Million TL in 1997, at 1977 constant prices; and fixed capital investments have increased from 524.6 Million TL in 1977 to 1,475.0 Million TL in 1997, at 1977 constant prices (Table-4.2). In spite of these developments, the investments and savings level, with respect to the economic potential of the TRNC and with respect to their share in GNP, is very low. Since, the share of domestic savings and investments in GNP is low (Table-4.3).

Propensity to invest and real investments in a country are accepted as indicators of economic development. The data in the determination of these indicators are the developments in the realisation of investments, in the import of investment goods and in the investment encouragement documents.

The share of fixed capital investments in the GNP has been very low within the period 1982-1997 and has been realized as 15.7% on the average (Table-4.3). For comparing; this ratio is 20.7% in India, 24.3% in France, 21%in Germany, 21.9% in Greece and 31.7 in Korea.[50] As can be followed, the propensity to invest is at a low level in the TRNC due to insufficient savings. The average ratio of domestic savings to GNP, for the realisation of investments, has been 11.7% within the period 1982-1997. This too is insufficient and therefore, average propensity to save is low in the TRNC.

[50] İktisadi Araştırmalar Vakfı, op.cit., p.40.

The need for keeping the investments at a specific level for economic development necessitates the increase in savings. When not able to increase the savings, the savings deficit should be met by external resources. When the developments are considered in this respect, it is obvious that, one of the basic problems of the economy of the TRNC is a low domestic saving inadequate to meet investments.

When we examine the investments-savings relationship is examined further it is clear that public-private differentiation has assumed large dimensions in the TRNC. In other words, because of the public savings deficit, private sector savings and external savings finance public investments.

On the other hand, an important portion of the private savings are not transferred to investments, but transferred to the public sector through the budget current expenditures for consumption and for financing the public sector deficits. Lending from private sector to public sector, or the yearly average increase in private savings that are transferred to the public sector in real terms, has been 8.0% within the period 1982-1997 (Table-4.3). At the same period, it can be seen that propensity to invest has been low, besides the fact that private savings could not be converted to investments. It is obvious that, this is one of the main problems of the economy of the TRNC.

Table-4.1 BALANCE OF INVESTMENTS AND SAVINGS

(Current Prices, Million TL)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
I. Total Investment	596.6	913.7	1,251.4	3,127.5	4,314.9	6,016.8	8,658.4	12,725.3	24,472.6	40,908.3
1. Fixed Capital	524.6	799.4	1,294.4	2,749.9	4,127.8	5,884.7	7,812.6	11,234.5	21,004.5	39,435.4
a) Public	206.7	285.4	277.0	632.2	1,461.7	1,745.8	3,203.7	5,095.6	7,626.4	10,913.9
b) Private	317.9	514.0	1,017.4	2,117.7	2,666.1	4,138.9	4,608.9	6,138.9	13,378.1	28,521.5
2. Changes in Stocks	72.0	114.3	-43.0	377.6	187.1	132.1	845.8	1,490.8	3,468.1	1,472.9
a) Public	-10.0	-15.9	-55.0	216.1	-54.2	-66.0	563.1	970.1	739.0	1,669.7
b) Private	82.0	130.2	12.0	161.5	241.3	198.1	282.7	520.7	2,729.1	-196.7
II. Total Savings	596.6	913.7	1,251.4	3,127.5	4,314.9	6,016.8	8,658.4	12,725.3	24,472.6	40,908.3
1. Domestic Savings	141.8	409.5	455.8	1,310.8	1,535.2	1,363.8	1,100.7	1,971.6	12,502.3	26,168.9
2. External Savings	454.8	504.2	795.6	1,816.7	2,779.7	4,653.0	7,557.7	10,753.7	11,970.3	14,739.4

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
I. Total Investment	59,839.5	83,974.4	141,867.3	260,301.0	372,913.4	639,115.9	1,197,935.8	2,388,525.3	4,826,688.7	9,899,941.2	24,127,203.2
1. Fixed Capital	55,981.9	75,297.5	129,204.9	236,220.0	350,594.5	536,155.3	1,049,499.0	2,215,173.7	4,247,018.7	8,842,789.4	21,890,828.2
a) Public	21,707.2	17,462.8	38,015.4	91,938.0	84,132.2	157,994.1	407,014.0	780,605.1	1,152,616.9	3,786,884.0	6,555,971.6
b) Private	34,274.7	57,834.7	91,189.5	144,282.0	266,462.3	378,161.2	642,485.0	1,434,568.6	3,094,401.8	5,055,905.4	15,334,856.6
2. Changes in Stocks	3,857.6	8,676.9	12,662.4	24,081.0	22,318.9	102,960.6	148,436.8	173,351.6	579,670.0	1,057,151.8	2,236,375.0
a) Public	1,324.9	4,190.3	4,719.1	10,390.4	9,400.1	55,764.1	45,461.2	32,928.5	122,801.5	373,361.5	854,841.5
b) Private	2,532.7	4,486.6	7,943.3	13,690.6	12,918.8	47,196.5	102,975.6	140,423.1	456,868.5	683,790.3	1,381,533.5
II. Total Savings	59,839.5	83,974.4	141,867.3	260,301.0	372,913.4	639,115.9	1,197,935.8	2,388,525.3	4,826,688.7	9,899,941.2	24,127,203.2
1. Domestic Savings	41,808.4	71,519.0	132,355.7	217,481.8	261,202.7	477,743.6	1,186,828.8	2,262,879.5	4,254,068.2	9,735,640.2	17,542,931.3
2. External Savings	18,031.1	12,455.4	9,511.6	42,819.2	111,710.7	161,372.3	11,107.0	125,645.8	572,620.5	164,301.0	6,584,271.9

Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-10, 1998 Lefkoşa, pp.15,16.

Table-4.2 BALANCE OF INVESTESTMENTS AND SAVINGS

(1977 Prices, Million TL)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
I. Total Investments	596.6	641.8	462.3	717.9	761.9	769.9	817.3	813.2	980.0	1,116.1	1,176.5	1,051.6	1,029.3	1,173.4	1,083.5	1,127.8	1,302.6	1,047.0	1,023.2	1,194.9	1,625.7
1. Fixed Capital	524.6	554.5	483.6	626.5	731.9	753.0	737.5	717.9	841.1	1,075.9	1,100.7	942.9	937.4	1,064.9	1,018.7	946.1	1,141.2	971.0	900.3	1,067.3	1,475.0
a) Public	206.7	199.8	106.0	150.8	266.1	223.4	302.4	325.6	305.4	297.8	426.8	218.7	275.8	414.5	244.5	278.8	442.6	342.2	244.3	457.1	441.7
b) Private	317.9	354.7	377.6	475.7	465.8	529.6	435.1	392.3	535.7	778.1	673.9	724.2	661.6	650.4	774.2	667.3	698.6	628.8	656.0	610.2	1,033.3
2. Changes in Stocks	72.0	87.3	-21.3	91.4	30.0	16.9	79.8	95.3	138.9	40.2	75.8	108.7	91.9	108.5	64.8	181.7	161.4	76.0	122.9	127.6	150.7
a) Public	-10.0	-12.1	-27.2	52.3	-8.7	-8.4	53.1	62.0	29.6	45.6	26.0	52.5	34.2	46.8	27.3	98.4	49.4	14.4	26.0	45.1	57.6
b) Private	82.0	99.4	5.9	39.1	38.7	25.3	26.7	33.3	109.3	-5.4	49.8	56.2	57.7	61.7	37.5	83.3	112.0	61.6	96.9	82.5	93.1
II. Total Savings	596.6	641.8	462.3	717.9	761.9	769.9	817.3	813.2	980.0	1,116.1	1,176.5	1,051.6	1,029.3	1,173.4	1,083.5	1,127.8	1,302.6	1,047.0	1,023.2	1,194.9	1,625.7
1. Domestic Savings	141.8	377.0	210.7	409.9	365.6	174.5	103.9	126.0	500.7	714.0	822.0	895.6	960.3	980.4	758.9	843.0	1,290.5	991.9	901.8	1,175.1	1,182.0
2. External Savings	454.8	264.8	251.6	308.0	396.3	595.4	713.4	687.2	479.3	402.1	354.5	156.0	69.0	193.0	324.6	284.8	12.1	55.1	121.4	19.8	443.7

Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-11, 1998 Lefkoşa, pp.17,18.

Table-4.3

Comparison of Public and Private Savings and Investments, Shares in GNP

(At 1977 constant prices, Million TL)

Years	GDP	Domestic Savings						Fixed Capital Investments						Total Invest.	% GDP	Private Savings Transferred to Public Sector	% GDP
		Public	% GDP	Private	% GDP	Total	% GDP	Public	% GDP	Private	% GDP	Total	% GDP				
1982	4,369.5	-578.8	-13.3	753.3	17.2	174.5	4.0	223.4	5.1	529.6	12.1	753.0	17.2	769.9	17.6	198.4	4.5
1983	4,440.4	-190.3	-4.3	294.2	6.6	103.9	2.3	302.4	6.8	435.1	9.8	737.5	16.6	817.3	18.4	-167.6	-3.8
1984	4,725.2	-258.5	-5.5	384.5	8.1	126.0	2.7	325.6	6.9	392.3	8.3	717.9	15.2	813.2	17.2	-41.1	0.9
1985	5,080.4	-389.0	-7.7	889.7	17.5	500.7	9.9	305.4	5.6	535.7	10.5	841.1	16.6	980.0	19.3	244.7	4.8
1986	5,324.1	-477.0	-9.0	1,191.0	22.4	714.0	13.4	297.8	5.6	778.1	14.6	1,075.9	20.2	1,116.1	20.0	418.3	7.9
1987	5,684.1	-69.4	-1.2	891.4	15.7	822.0	14.5	426.8	7.5	673.9	11.9	1,100.7	19.4	1,176.5	20.7	167.7	3.0
1988	6,084.0	393.4	6.0	502.2	8.3	895.6	14.7	218.7	3.6	724.2	11.9	942.9	15.5	1,051.6	17.3	-278.2	-4.6
1989	6,603.0	288.3	4.4	672.0	10.2	960.3	14.5	275.8	4.2	661.6	10.0	937.4	14.2	1,029.3	15.5	-47.3	-1.0
1990	6,977.4	250.5	3.6	729.9	10.5	980.4	14.1	414.5	5.9	650.4	9.3	1,064.9	15.3	1,173.4	16.8	17.8	0.3
1991	6,606.4	-115.1	-1.7	874.0	13.2	758.9	11.5	244.5	3.7	774.2	11.7	1,018.7	15.4	1,083.5	16.4	62.3	1.0
1992	7,124.7	-201.5	-2.8	1,044.5	14.7	843.0	11.8	278.8	3.9	667.3	9.4	946.1	13.3	1,127.8	15.8	293.9	4.1
1993	7,547.4	5.1	0.1	1,285.4	17.0	1,290.5	17.1	442.6	5.9	698.6	9.3	1,141.2	15.1	1,302.6	17.3	474.8	6.3
1994	7,268.3	0.7	0.01	991.2	13.6	991.9	13.7	342.2	4.7	628.8	8.7	971.0	13.4	1,047.0	14.4	300.8	4.1
1995	7,457.8	-659.9	-8.9	1,561.7	21.0	901.8	12.1	244.3	3.3	656.0	8.8	900.3	12.1	1,023.2	13.7	808.8	10.9
1996	7,673.4	-406.8	-5.3	1,581.9	20.6	1,175.1	15.3	457.1	6.0	610.2	8.0	1,067.3	13.9	1,194.9	15.6	889.2	11.6
1997	7,966.2	-483.9	-6.1	1,665.9	20.9	1,182.0	14.8	441.7	5.6	1,033.3	13.0	1,475.0	18.5	1,625.7	20.4	539.5	6.8

--Prepared by using the statistics of the State Planning Organisation.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Tables-3 and 11, 1998 Lefkoşa, pp. 3,17,18.

4.2 Sectoral Distribution of Fixed Capital Investments

Fixed capital investments in the TRNC have reached 21,890,828.2 Million TL at current prices in 1997 (Table-4.4) and increased from 524.6 Million TL in 1977 to 1,475.0 Million TL in 1997, at 1977 constant prices. This increase in real terms amounts to an increase of 181.2% in total and a yearly average increase of 5.2%, within the period 1977-1997 (Table4.5). Besides the increase in fixed capital investments, its sectoral distribution is also important. The distribution of fixed capital investments is effective from the aspect of improving productivity and production capacity for the future years.

Dwellings sector is where most of the fixed capital investments are concentrated within the period 1977-1997, when the constant prices are considered. Dwellings sector is followed by industry and communication-transportation sectors. In the specified period, 38.0% of fixed capital investments were realized in dwellings sector, 14.5% in industry, and 16.6% in communications and transportation sector, 9.0% in agriculture and 8.9% in trade and tourism sector on the average (Table-4.6).

Public investments that were realized in this period are mainly concentrated on communication and transportation, education, health, public services, electricity and water sectors. Private sector investments are mainly concentrated on dwellings, manufacturing industry and trade sectors, in the specified period.

As can be seen from Tables-4.5 and 4.6, the public sector investments are concentrated on basic infra structure investments and on services mainly related to education and health. Public sector investments are concentrated on dwellings sector and have been low in production-diverted sectors, industry and agriculture. The sectors specifying the production capability and meeting the demand are the agricultural and energy sectors, which perform real production. Any weakness in the production capability, or disability in increasing the production capability, will decrease the development rate of other sectors and will create a restricting effect on the development of the economy. From this point of view, low shares of the investments in the specified sectors are the cause of limited production in the economy of the TRNC. On the other hand, this situation will have negative effect on the restructuring of the economy in the TRNC.

When the development of the manufacturing industry investments for the period 1982-1997 is considered, it can be seen that the share of manufacturing industry investments in total private sector investments has decreased. The yearly average decrease of manufacturing industry investments for the period have been 2.2% while the yearly average increase in private sector fixed capital investments have been 4.9% in real terms (Tables-4.4, 4.5). Transfer of private savings to public sector at considerable amounts during the period, have been effective in the decrease in manufacturing industry investments (Table-4.3). As mentioned before, these transfers from the private savings to the public sector are used for meeting the budget current expenditures and for financing the public sector deficits. Therefore, the increase in the public deficits has created a negative effect on the manufacturing industry investments. In this way, the resources that could be converted to investments have been transferred to unproductive fields. Thus, the increase in the public deficits created a crowding out effect on the manufacturing industry investments which are important productive investments for the economy.

Table-4.4 SECTORAL DISTRIBUTION OF FIXED CAPITAL INVESTMENTS

(Current Prices, Million TL)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
I Agriculture	67.0	141.7	167.0	228.5	518.1	978.0	1,375.6	1,275.0	1,636.7	2,208.1	1,311.3	1,822.1	7,581.8	16,266.1	16,162.2	41,436.0	107,487.6	108,302.5	291,464.7	972,544.8	701,828.8
II Industry	86.2	112.7	231.1	515.8	667.5	812.5	1,972.0	2,323.0	5,399.6	6,804.5	8,571.8	10,059.4	14,832.0	29,880.2	47,828.9	67,761.8	91,320.5	220,397.8	424,679.9	641,972.2	1,516,176.8
1. Quarrying(x)																	1,417.7	3,075.3	6,207.4	9,490.6	18,436.1
2. Manufacturing	44.1	54.4	169.3	369.3	392.7	680.3	1,530.4	1,698.6	2,136.3	5,587.6	4,244.4	7,602.6	10,835.1	22,279.1	29,068.4	47,532.2	63,522.3	152,849.0	333,171.6	468,053.6	945,379.5
3. Electricity-Water	42.1	58.3	61.8	146.5	274.8	132.2	441.6	624.4	3,263.3	1,216.9	4,327.4	2,456.8	3,996.9	7,601.1	18,760.5	20,229.6	26,380.5	64,473.5	85,300.9	164,428.0	552,361.2
III Construction	4.0	3.3	5.3	10.8	17.8	61.6	35.9	234.3	305.1	239.9	580.7	1,201.3	1,915.6	7,281.6	4,987.8	14,124.5	15,514.2	60,767.9	86,069.4	200,348.3	439,043.6
IV Trade-Tourism	35.0	74.6	126.7	291.7	329.7	398.9	486.5	933.5	2,435.3	2,996.0	4,443.7	9,174.1	19,120.7	17,135.1	34,897.0	48,118.7	101,810.7	163,867.3	426,138.3	626,409.4	1,949,012.9
1. Trade	24.3	37.7	100.0	273.3	258.2	276.5	435.9	762.1	2,285.6	2,552.2	3,026.0	5,894.5	11,412.6	11,148.9	29,547.9	27,794.5	66,212.0	109,360.4	264,536.6	302,972.2	899,533.5
2. Tourism	10.7	36.9	26.7	18.4	71.5	122.4	50.6	171.4	149.7	443.8	1,417.7	3,279.6	7,708.1	5,986.2	5,349.1	20,324.2	35,598.7	54,506.9	161,601.7	323,437.2	1,049,479.4
V Transport-Communication	94.2	70.9	83.4	173.9	668.1	1,048.5	1,442.8	2,423.1	2,875.4	5,518.1	10,982.3	7,428.1	15,892.6	65,352.6	37,814.5	92,630.1	249,108.4	461,624.4	842,922.7	2,391,711.7	3,319,165.1
VI Transport-Communication	9.5	7.9	12.4	25.6	42.1	145.8	85.1	69.9	50.2	222.9	570.3	1,011.7	816.2	315.9	4,247.2	3,627.0	10,508.7	21,223.1	46,561.4	70,784.2	261,534.1
VII Owner Of Dwellings	195.9	302.9	609.8	1,340.4	1,585.8	2,038.3	1,692.6	2,762.6	6,440.5	18,717.8	22,770.4	37,385.5	51,487.6	76,299.5	161,591.9	215,598.6	351,491.0	877,764.8	1,649,636.3	2,306,770.3	9,132,236.9
VIII Business and Personal Services	-	-	-	4.5	25.8	51.6	86.5	84.8	91.0	332.4	1,829.2	2,098.1	4,795.0	7,118.4	12,850.3	12,470.2	20,450.7	59,868.9	121,666.9	256,676.7	1,062,220.0
IX Public Services	32.8	85.4	58.7	158.7	272.9	349.5	635.6	1,128.3	1,770.7	2,395.7	4,922.2	5,117.2	12,763.4	16,570.6	30,214.7	40,388.4	101,807.2	241,357.0	357,879.1	1,375,571.8	3,509,610.0
1. Health	13.3	4.3	2.8	25.9	16.6	2.9	15.1	39.0	42.3	220.8	497.4	1,034.9	6,246.9	2,530.6	3,964.1	3,278.7	13,645.3	14,430.8	31,286.6	168,448.4	246,286.6
2. Education	3.7	9.9	21.6	71.3	95.4	100.9	185.3	215.2	385.0	432.1	975.4	1,263.9	2,905.0	7,651.2	9,935.3	14,578.4	53,355.4	108,745,3	159,218.3	462,082.5	1,483,737.4
3. Other	15.8	71.2	34.3	61.5	160.9	245.7	435.2	874.1	1,343.4	1,742.8	3,449.4	2,818.4	3,611.5	6,388.8	16,315.3	22,531.3	34,806.5	118,180.9	167,374.2	745,040.9	1,779,586.0
Total	524.6	799.4	1,294.4	2,749.9	4,127.8	5,884.7	7,812.6	11,234.5	21,004.5	39,435.4	55,981.9	75,297.5	129,204.9	236,220.0	350,594.5	536,155.3	1,049,499.0	2,215,173.7	4,247,018.7	8,842,789.4	21,890,828.2

(x) Included in Manifacturing Industry until 1993

Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-12, 1998 Lefkoşa, pp 19,20

Tabe-4.5 SECTORAL DISTRIBUTION OF FIXED CAPITAL INVESTMENTS

(1977 Prices, Million TL)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
I. Agriculture	67.0	100.0	60.9	49.8	88.9	125.1	129.9	81.5	65.4	60.3	25.8	22.8	55.0	73.3	47.0	73.1	116.9	47.5	61.8	117.4	47.3
II. Industry	86.2	76.4	81.7	108.8	108.2	104.0	186.2	148.5	216.2	185.6	168.5	126.0	107.6	134.7	139.0	119.6	99.3	96.6	90.1	77.5	102.1
1. Quarrying (x)																	1.5	1.3	1.3	1.1	1.2
2. Manufacturing	44.1	37.0	60.0	77.2	63.9	87.1	144.5	108.6	85.6	152.4	83.4	95.2	78.6	100.4	84.5	83.9	69.1	67.0	70.6	56.5	63.7
3. Electricity-Water	42.1	39.4	21.7	31.6	44.3	16.9	41.7	39.9	130.6	33.2	85.1	30.8	29.0	34.3	54.5	35.7	28.7	28.3	18.2	19.9	37.2
III. Construction	4.0	2.3	1.9	2.4	3.0	7.9	3.4	15.0	12.2	6.5	11.4	15.0	13.9	32.8	14.5	24.9	16.9	26.6	18.2	24.2	29.6
IV. Trade-Tourism	35.0	49.4	46.3	64.0	55.5	51.1	46.0	59.6	97.5	81.7	87.4	114.9	138.7	77.3	101.4	84.9	110.7	71.8	90.3	75.6	131.6
1. Trade	24.3	25.6	36.6	60.0	43.9	35.4	41.2	48.7	91.6	69.6	59.5	73.8	82.8	50.3	85.9	49.0	72.0	47.9	56.0	36.6	60.6
2. Tourism	10.7	23.8	9.7	4.0	11.6	15.7	4.8	10.9	5.9	12.1	27.9	41.1	55.9	27.0	15.5	35.9	38.7	23.9	34.3	39.0	70.7
V. Transport-Communication	94.2	51.5	34.9	47.9	125.8	134.1	136.2	154.8	115.2	150.5	215.9	93.0	115.3	294.6	109.9	163.5	270.9	202.4	178.7	288.7	223.7
VI. Transport-Communication	9.5	5.3	4.5	5.6	7.2	18.7	8.0	4.5	2.0	6.1	11.2	12.6	5.9	1.4	12.3	6.4	11.4	9.3	9.8	8.5	17.6
VII. Ownership Of Dwellings	195.9	211.4	231.6	310.0	291.2	260.8	159.6	176.5	258.1	510.7	447.7	468.2	373.6	344.0	469.5	380.4	382.2	384.8	349.7	278.4	615.3
VIII. Business and Personal Servic	-	-	-	1.2	4.5	6.6	8.2	5.4	3.6	9.1	36.0	26.3	34.8	32.1	37.3	22.0	22.2	26.2	25.8	31.0	71.6
IX. Public Sevices	32.8	58.2	21.8	36.8	47.6	44.7	60.0	72.1	70.9	65.4	96.8	64.1	92.6	74.7	87.8	71.3	110.7	105.8	75.9	166.0	236.5
1. Health	13.3	2.9	1.0	6.7	2.9	0.4	1.4	2.5	1.7	6.0	9.8	13.0	45.3	11.4	11.5	5.8	14.8	6.3	6.6	20.3	16.6
2. Education	3.7	6.9	8.2	16.6	17.4	12.9	17.5	13.7	15.4	11.8	19.2	15.8	21.1	34.5	28.9	25.7	58.0	47.7	33.8	55.8	100.0
3. Other	15.8	48.4	12.6	13.5	27.3	31.4	41.1	55.9	53.8	47.6	67.8	35.3	26.2	28.8	47.4	39.8	37.9	51.8	35.5	89.9	119.9
Total	524.6	554.5	483.6	626.5	731.9	753.0	737.5	717.9	841.1	1,075.9	1,100.7	942.9	937.4	1,064.9	1,018.7	946.1	1,141.2	971.0	900.3	1,067.3	1,475.0

(x) Included in Manufacturing Industry until 1993

Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-13, 1998 Lefkoşa, p.21.

Table-4.6 Sectoral Shares of Fixed Capital Investments

(At 1977 constant prices)

Years	Total Fixed Capital Invest. (mil.TL)	Agriculture %	Industry %	Construction %	Trade-Tourism %	Communication & Transportation %	Fiscal Institutions %	Ownership of Dwellings %	Business and Personal Services %	Public Services %
1977	524.6	12.8	16.4	1.0	6.7	18.0	2.0	37.3	-	6.3
1978	554.5	18.0	13.8	0.4	8.9	9.3	1.0	38.1	-	10.5
1979	483.6	12.6	16.9	0.3	9.6	7.2	1.0	47.9	-	4.5
1980	626.5	7.9	17.4	0.4	10.2	7.6	1.0	49.5	0.1	5.9
1981	731.9	12.1	14.8	0.4	7.6	17.2	1.0	39.8	0.6	6.5
1982	753.0	16.6	13.8	1.0	6.7	17.8	2.5	34.6	0.8	5.9
1983	737.5	17.6	25.3	0.5	6.2	18.5	1.1	21.6	1.1	8.1
1984	717.9	11.4	20.7	2.1	8.3	21.6	0.6	24.6	0.8	10.0
1985	841.1	7.8	25.7	1.5	11.6	13.7	0.2	30.7	0.4	8.4
1986	1075.9	5.6	17.3	0.6	7.6	14.0	1.0	47.5	0.8	6.1
1987	1100.7	2.3	15.3	1.0	7.9	19.6	1.0	40.7	3.3	8.8
1988	942.9	2.4	13.4	1.6	12.2	9.7	1.3	49.7	2.8	6.8
1989	937.4	5.9	11.5	1.5	14.8	12.3	0.6	39.9	3.7	9.9
1990	1064.9	6.9	12.7	3.1	7.3	27.7	0.1	32.3	3.0	7.0
1991	1018.7	4.6	13.6	1.4	10.0	10.8	1.2	46.1	3.7	8.6
1992	946.1	7.7	12.6	2.6	9.0	17.3	0.6	40.2	2.3	7.5
1993	1141.2	10.2	8.7	1.5	9.7	23.7	1.0	33.5	2.0	9.7
1994	971.0	4.9	10.0	2.7	7.4	20.8	1.0	39.6	2.7	10.9
1995	900.3	6.7	10.0	2.0	10.0	19.9	1.1	38.8	2.9	8.4
1996	1067.3	11.0	7.3	2.3	7.1	27.1	0.7	26.1	2.9	15.6
1997	1475.0	3.2	6.9	2.0	8.9	15.2	1.1	41.7	4.9	16.0

--Shares are calculated by using the statistics of the State Planning Organization.
--Source: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-13, 1998 Lefkoşa, p.21.

4.3 The Effect of Treasury Borrowings on the Funds that are Transferable to the Private Sector

The treasury has to apply to the resources of the Central Bank and commercial banks for financing the budget deficits. Since the liquid resources of the commercial banks are limited, domestic borrowings either will create monetary expansion by effecting the money reserves or will restrict the credit possibilities for the private sector (financial crowding out). If a deficit occurs in the budget, this has to be financed either by increasing the taxes or by internal borrowing from the Central Bank. Thus, either the deficit is monazited or the problem is postponed to future by domestic borrowing.

In this section, the issue whether the borrowing of the treasury create financial crowding out on the funds that are transferable to the private sector or not will be discussed. For this purpose, the shares received by the public sector from the Central Bank credits and from the commercial banks credits will be examined. The treasury does not use credits from the commercial banks. Therefore the portion of the commercial banks' credits which are lent to the public and private sectors from the commercial banks will be analysed.

Domestic borrowing should be examined from three perspectives:

1- The perspective that examines the objective and place of use of the Domestic borrowing:

In cases where the public sector financing is in balance and even when there is a surplus, domestic borrowing is used as a tool for slowing down the increase in demand. This alternative is invalid for the TRNC. As the second alternative, although the domestic borrowing is used for financing the public deficit, it might be transferred to public infra structure investments. If the advantage of the investment is high, this will induce the private sector investments and their productivity will increases (crowding in). This alternative is also invalid for the TRNC, since the borrowings of the treasury are used for meeting the budget current expenditures and for meeting the losses of the public economic enterprises; also, we can not say that there are any signs of induced investments in the TRNC. As the third alternative, the amount borrowed might be used for investments in the areas where a competition with the private sector may occur. This alternative is also invalid for the TRNC, since the borrowings from the treasury are not used for investments, but as we mentioned before, are used for meeting the current budget expenditures and for meeting the losses of public economic enterprises. As the fourth alternative, the borrowings from the treasury might be used for meeting the domestic – external debt services. This alternative is also invalid for the TRNC, since the main source of external borrowing is Turkey and these borrowings are like aid more than loans and are not paid back.

2- Perspective that examines the effects of borrowing from the treasury, on the interest rates:

If the treasury is in competition with the private sector for the funds, this competition will have some effects on the interest rates. This issue has been discussed in the previous sections.

3- Another perspective examines if there is crowding out effect in the short-run, regardless of the way the borrowed money is used and the developments in the long run. The first question for this perspective is to check if any increases in borrowings in real terms have been recorded. The second step is to investigate if the share of public sector in the total resources that are lent by the Central Bank (advances and rediscounts) are increased. The third step is to investigate the share of public sector, in the advances and loans lent by the Central Bank and the commercial banks in the period under consideration. This perspective seems more valid for the case in the TRNC. For this purpose, Table-4.6, Table-4.7 and Table-4.8 will be examined in the next section.

4.3.1 The Case in the TRNC

In this section, the advances and rediscounts lent from the Central Bank's resources and the sectoral distribution of advances, loans and the bills discounted by the commercial banks and the Central Bank as a whole will be analysed for the period 1992-1997.

Table-4.7 shows the total amounts of Turkish Lira and Foreign Currency advances and rediscounts from the Central Bank's resources that are lent to the public sector directly and to the other sectors through the commercial banks. The public sector receive these credits from the Central Bank resources in two ways:

i- To the Public Corporations and Institutions in the form of Advances under Treasury guarantee.

ii- To the Treasury Department as Short Term Advances.

On the other hand, commercial banks receive the credits from the Central Bank's resources in the form of industrial, export, commercial, tourism, agricultural, artisans and small shopkeepers bills and as advances against foreign currency.

Table-4.7

Comparison of Balances Due under Turkish Lira and Foreign Currency Advances and Rediscounts from the Central Bank's Resources

(Million TL)

Debtor	Dec 1992	Dec 1993	Dec 1994	Dec 1995	Dec 1996	Dec 1997
I. Public Corporations and Institutions (Adv. Under Treasury Guar.)	**35,430.3**	**63,588.4**	**111,712.9**	**424,679.3**	**827,485.6**	**1,574,789.4**
1. Cypruvex Ltd.	33,772.7	60,807.0	106,893.7	187,910.4	394,644.3	794,824.1
2. Agr. Machinery Corpor.	1,557.6	2,741.4	4,819.2	8,471.7	14,963.1	26,335.0
3. State Prod. Farm	-	-	-	14,391.1	10,678.5	20,289.1
4. Agr. Produce Corpor.	-	-	-	163,227.4	311,339.5	591,545.1
5. Cyp.T.Tourism Ent.Ltd	100.0	40.0	-	-	-	-
6. Akdeniz Garanti Bank	-	-	-	50,678.7	95,860.2	186,796.1
II. Treasury Department (Short Term Advance)	**75,000.0**	**255,000.0**	**970,000.0**	**5,470,000.0**	**11,808,000.0**	**19,861,043.0**
III. Commercial Banks (Lending through Com. Banks)	**51,215.0**	**159,350.3**	**149,611.5**	**437,543.6**	**1,594,857.6**	**3,547,504.3**
1. Industrial Bills	14,944.0	33,401.0	55,459.6	60,567.3	85,444.0	160,534.5
2. Export Bills	4,355.0	75,000.0	50,461.5	133,275.8	277,200.3	474,402.7
3. Commercial Bills	20,500.0	500.0	-	148,941.9	283,592.7	1,088,728.4
4. Tourism Bills	4,426.5	7,066.2	1,852.8	5,119.4	10,227.2	14,829.4
5. Agricultural Bills	82.3	50.6	9.0	-	525,890.4	1,104,111.0
6. TL Advanced Against Foreign Currency	-	-	-	39,220.0	268,247.0	548,854,0
7. Artisans and Small Shopkeepers Bills	6,907.2	43,332.5	41,828.5	50,419.2	144,256.0	156,044.3
Total	**161,645.3**	**477,938.7**	**1,231,324.4**	**6,332,222.9**	**14,230,343.2**	**24,983,336.7**

--Prepared by using the statistics of the Central Bank.
--Sources: Central Bank of TRNC, Bulletin No: 22, Table-2, p.8
Central Bank of TRNC, Bulletin No: 23, Tables-2,4, pp.8-12.
Central Bank of TRNC, Bulletin No: 24, Tables-2,4, pp.10-12, 15-16.
Central Bank of TRNC, Bulletin No: 25, Tables-2,4, pp.7-8, 11-12.
Central Bank of TRNC, Bulletin No: 26, Tables-2,4, pp.7-8, 11-12.
-- Advances and Rediscounts in Foreign Currency are converted into Turkish Lira at the Annual Average Exchange rates given by Ekonomik ve Sosyal Göstergeler, DPÖ, Table-25, p.39.

Table-4.7 shows that the amount of advances and rediscounts that are lent to the Public Corporations and Institutions under treasury guarantee from the Central Bank's resources, has increased from 35,430.3 Million TL in

1992 to 1,574,789.4 Million TL in 1997 at current prices. This result amounts to an increase of 4,344.8% in total and an average yearly rise of 75.9% for the period.

Short-term advances received by the treasury department from the Central Bank's resources have increased from 75,000.0 million TL in 1992 to 19,861,043.0 TL in 1997 at current prices. This result amounts to an increase of 26,381.4% in total and an average yearly rise of 111.6% for the period.

Total amount of resources that are transferred from the Central Bank's resources to the public sector (The sum received by the Public Corporations and Institutions and by the Treasury Department), is increased from 110,430.3 Million TL in 1992 to 21,435,832.4 TL in 1997 at current prices. This result amounts to an increase of 19,311.2% and an average yearly rise of 105.4% for the period (Table-4.7).

The amount of resources from the Central Bank's resources that have been transferred to the commercial banks in the form of bills and advances has increased from 51,215.0 Million TL in 1992 to 3,547,504.3 Million TL in 1997. This amounts to an increase of 6,826.7% in total and an average yearly rise of 84.8% for the period.

Above results show that the rate of increase of the resources received by the public sector from the Central Bank's resources is higher than the rate of increase of the resources received by the commercial banks from the Central Bank's resources.

Also, it is observed from Table-4.6 that Cypruvex Ltd absorbs the highest share in the amount received by the Public Corporations and Institutions for all the years within the period. This is another confirmation that an important part of the public deficits and budget deficits is due to meeting the continuous losses of Cypruvex Ltd. as mentioned in Chapter II and Chapter III.

Table-4.8 Shares in Total Advances and Rediscounts from the Central Bank's Resources, With Regard to Years

Years	Public Corp. & Inst.		Treasury Depart.		Commercial Banks		Total
	Amount (Mil. TL)	%	Amount (Mil. TL)	%	Amount (Mil. TL)	%	(Mil. TL)
1992	35,430.3	21.92	75,000.0	46.40	51,215.0	31,68	161,654.3
1993	63,588.4	13.30	255,000.0	53.35	159,350.3	33.35	477,938.7
1994	111,712.9	9.07	970,000.0	78.78	149,611.5	12.15	1,231,324.4
1995	424,679.3	6.71	5,470,000.0	86.38	437,543.6	6.91	6,332,222.3
1996	827,485.6	5.81	11,808,000.0	82.98	1,594,857.6	11.21	14,230343.2
1997	1,574,789.4	6.30	19,861,043.0	79.50	3,547,504.3	14.20	24,983,336.7

--Prepared by using the statistics of the Central Bank.
--Sources: KKTC Başbakanlık, DPÖ, Ekonomik ve Sosyal Göstergeler, Table-25, 1998 Lefkoşa, p.39.
Central Bank of TRNC, Bulletin No: 22, Table-2, p.8
Central Bank of TRNC, Bulletin No: 23, Tables-2,4, pp.8-12.
Central Bank of TRNC, Bulletin No: 24, Tables-2,4, pp.10-12, 15-16.
Central Bank of TRNC, Bulletin No: 25, Tables-2,4, pp.7-8, 11-12.
Central Bank of TRNC, Bulletin No: 26, Tables-2,4, pp.7-8, 11-12.

Table-4.8 shows the shares in total advances and rediscounts that Public Corporations and Institutions, Treasury Department and the Commercial Banks have received from the Central Bank's resources. The share of Treasury department, which received the resources in the form of short-term advances has increased from 46.40% in 1992 to 79.50% in 1997, the highest value attained being 86.38% in 1995. This results shows a total increase of 71.34% and an average yearly rise of 10.8% in the share of Treasury Department in total advances and rediscounts from the Central Bank's resources within the period. The average share of the short term advances received by the Treasury Department in total advances and rediscounts from the Central Bank's resources have been 71.23% for the period.

The share of Public Corporations and Institutions that receive advances under treasury guarantee Central Bank's resources has followed a steady decrease from 21.92% in 1992 to 6.30% in 1997. This result shows a decrease of 71.26% in total and an average yearly decrease of 24.9% for the period. But it is noted that, while the share of Public Corporations and Institutions in total resources lent by the Central Bank decreases, the share of direct borrowing (short term advances) by the treasury department from the Central Bank's resources increased in greater proportions. Also it is noted that, although the share of Public Corporations and Institutions has decreased steadily within the period, the highest share has been Cypruvex Ltd's among the public corporations and institutions for each year in the period.

Total share of the resources that are transferred to the public sector (the sum of the shares of public corporations and institutions and the treasury department) in total resources from the Central Bank or in other words, total borrowing of the treasury has increased from 68.32% in 1992 to 85.80 in 1997. The period's highest recorded has been 93.09 in 1995. This result amount to an increase in total of 25.59% and an average yearly rise of 4.6% in the total share of resources received by the public sector from Central Bank's resources within the period. In other words, borrowing of the treasury from the Central Bank has increased by 4.6% yearly average within the period. The average share of the resources that are transferred to the public sector in total resources from the Central Bank has been 81.75% for the period 1992-1997. It has been mentioned in Chapter II and Chapter III that these sources are used for meeting the current expenditures and for meeting the loss of Public Economic Enterprises, mainly Cypruvex Ltd in the period.

The share of the resources that are transferred to the commercial banks in the total resources from the Central Bank has decreased from 31.68% in 1992 to 14.20% in 1997. This result shows a decrease of 55.18% in total and an average yearly decline of 16.1% in the share of the resources transferred to the commercial banks in total resources from the Central Bank within the period. The average share of the resources transferred to the commercial banks in total resources from the Central Bank has been 18.25% for the period. It is noted that the resources that are transferred to the commercial banks in the form of bills and advances are intended to encourage the private sector.

It is obvious from the results above that borrowing by the state is increased and the share of the public sector in the total resources lent by the Central

Bank from its own resources is increased during the period 1992-1997. As shown, about 82.0% of the financial resources lent by the Central Bank from its own resources are used by the public sector, while about 18.0% is lent to the commercial banks for the use of firms. But it is noted that it is possible for the public corporations and institutions to ask for loans from the commercial banks. Therefore, the shares used by the private sector firms from the Central Bank's resources through the commercial banks may be even lower than 18.0%. It is very clear from these results that financial opportunities of the private sector are highly restricted at the expense of financing the current expenditures of the public sector and financing the losses of public economic enterprises, as mentioned in Section 3 of this Chapter. Thus, as a result of this analysis we can say that there is financial crowding out that occurs due to the financing part of the public and budget deficits in the TRNC.

Table-4.9 shows the sectoral distribution of the Turkish Lira and Foreign Currency advances, loans and bills discounted by the commercial banks and the Central Bank as a whole, for the period 1992-1997. When Table-4.9 is analysed, it can be seen that the highest share in the total loans, advances and bills discounted is the share received by the State Economic Enterprises for each year in the period. The period's average for the share of Public Economic Enterprises in the total loans, advances and bills discounted has been 44.96% while the average share for the manufacturing industry has been 1.66% and the average share for tourism has been 2.04% for the period. The second highest share for the period has been the share of Foreign and Domestic Trade with an average of 30.60%. Imports like the Electricity Plant Equipment and Agricultural Machinery and Equipment carried out by the state during the period have been effective in the high share of Foreign and Domestic Trade. These results are also a good indication about the high share of the public in the economy and that the financial opportunities of the private sector have been restricted by the public sector.

Table-4.9 Comparison of Turkish Lira and Foreign Currency Advances, Loans, and Bills Discounted on Sectoral Basis

(Million TL)

	Dec 1992		Dec 1993		Dec 1994		Dec 1995		Dec 1996		Dec 1997	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
State Economic Enterprises	2,900,611.5	71.58	881,582.4	27.42	2,777,019.4	30.85	9,483,286.4	37.84	23,017,662.8	50.00	58,100,828.2	52.04
Agriculture	68,224.5	1.68	171,137.5	5.32	196,074.7	2.18	536,366.4	2.14	1,145,350.5	2.50	2,501660.8	2.24
Manufacture	46,667.3	1.15	133,725.5	4.16	172,764.7	1.92	190,073.5	0.76	507,856.5	1.11	930,865.6	0.83
Transport & Communication	22,309.2	0.55	7,843.8	0.24	13,053.3	0.14	4,671.1	0.02	33,772.0	0.02	338,537.1	0.30
Foreign and Domestic Trade	721,530.4	17.81	1,257,314.2	39.10	2,767,473.0	30.74	9,284,280.3	37.05	14,072,920.5	30.56	31,620,827.3	28.32
Tourism	69,087.0	1.70	96,868.2	3.01	238,150.2	2.65	493,304.6	1.97	714,424.1	1.55	1,533,509.2	1.37
Building and Construction	20,861.3	0.52	25,458.7	0.79	57,506.8	0.64	63,069.1	0.25	463,257.9	1.02	1,492,460.1	1.34
Personal and Professional Loans	160,699.8	3.97	591,914.4	18.41	2,710,302.1	30.10	4,558,930.9	18.19	5,146,963.0	11.18	13,629,099.6	12.21
Bills Discounted	42,116.9	1.04	49,708.9	1.55	70,381.3	0,78	447,105.5	1.78	945,254.7	2.06	1,507,589.0	1.35
Total	4,052,107.9	100.0	3,215,553.6	100.0	9,002,725.6	100.0	25,061,087.8	100.0	46,047,462.0	100.0	111,655,376.9	100.0

--Prepared by using the statistics of the Central Bank..
--Sources: Central Bank of TRNC, Bulletin No: 22, Table-11, p.43
Central Bank of TRNC, Bulletin No: 23, Table-14, p.45
Central Bank of TRNC, Bulletin No: 24, Table-14, p.50
Central Bank of TRNC, Bulletin No: 25, Table-14, p.44
Central Bank of TRNC, Bulletin No: 26, Tables-14, 37, 43, pp.46,88,94.
--The amount shown under State Economic Enterprises includes advances given by the Central Bank•

• Short Term Advances lent by the Central Bank to the Treasury Department is not included.

5. Conclusion of Chapter IV

In this Chapter, the effects of budget deficits on the economy is discussed in detail. Various methods are used for investigating whether there exist any effects of the budget deficits on the economy of the TRNC. Interest rates, Balance of Investments and Savings, developments in the Fixed Capital Investments and the distribution of Advances and Rediscounts from the Central Bank's resources together with the sectoral distribution of Advances, Loans and Bills Discounted from the whole banking sector are all analysed in a time perspective for this purpose.

It is not possible to say that interest rates in the TRNC are influenced by the budget deficits in considerable amounts. But there might be a slight influence due to the domestic borrowing, which might not be the main factor in the increase of the interest rates. High interest rates are due to the imported inflation from Turkey as a result of using Turkish Lira as legal tender in the TRNC.

External saving is still an important issue in setting this balance although the domestic savings deficits are diminishing. Because of the insufficiency in savings, propensity to invest is at a low level in the TRNC. Private sector savings and external savings are used in financing the public investments because of the public savings deficit. But, an important portion of the private savings are not transferred to investments but transferred to the public sector through the budget expenditures for consumption and for financing the public deficits.

Increase in public deficits created a negative effect on the manufacture industry, the improvement of which indicates the productivity and production capacity for the future years. Crowding out effect created on the manufacturing industry investments. This situation is expected to have some negative effects on the restructuring of the economy of the TRNC.

Domestic borrowing of the state of the TRNC is increasing. Shares of the public sector in the financial resources that are lent by the Central Bank from its own resources and by the banking sector is very high. Current expenditures of the public sector and the losses of the Public Economic Enterprises are financed at the expense of restricting the financial opportunities of the private sector. Therefore it is certain that financial crowding out is created as a result of financing the budget deficits in the TRNC.

Recall from Chapter I that government borrowing reduces private investment and it plays a key role in the neo-classical analysis. The crowding out hypothesis of the neo-classical approach says that when the public sector draws on the pool of resources available for investment, private investment is crowded out;[51] this holds for the case in the TRNC.

[51] Harvey, op.cit., p.467.

V. CONCLUSION

a) Summary and Discussions

Fiscal activities of the government influence the economic and social life too. Today, using fiscal policy tools orients economic and social life. Because of this, the budget is not only an instrument for determining the public revenues and expenditures according to the communal needs and finding sources for them, but also its an important tool for realising the planned growth and social structure while targeting the struggle against inflation. With the budget, improving the infrastructure through the effective and efficient use of the national resources, increasing the production of goods and services, improving the distribution of income, expanding social justice, overcoming the regional imbalances and increasing the level of public services is targeted.

As a result of the analysis done within the frame of this study, it is obvious that the goals of budget that are mentioned above are not consistent with the present practice in the TRNC, and these goals could not have been reached through the policies applied during the period of 1977-1997.

Financing the budget deficits is one of the important problems in the economy. Participation of the state in the economy as a goods and services producing sector, creates the need for financing these activities. When the budget expenditures exceed the budget revenues or when the revenues are so depreciated that can not meet the expenditures, budget deficits occur and the need for financing these deficits is created. In the cases like this, government transfers some surpluses (resources) from the private and foreign sectors in order to finance the deficits.

In Chapter I of this study, the theoretical approaches about financing the budget deficits by borrowing (debt financing) instead of tax financing has been summarized. According to Standard neo-classical model, because of the net wealth effect at full employment level, budget deficit cause increases in consumption while on the other hand cause inevitable decreases in savings. In this case for maintaining the saving-investment balance interest rates increases creating a negative effect on the private sector investments. The existence of resources that are not fully employed in the economy is the main difference between the Keynesian approach and neo-classical approach. According to Keynesian approach, the negative effect due to the budget deficits on the capital stock can only be possible when the full employment level is attained. According to the Ricardian Equivalence Theorem financing by borrowing results in high rate of taxation in the future periods. Because of this, rational consumer increases his or her savings in order to meet the future tax payments, considering his or her lifetime income without changing his or her consumption pattern. As a conclusion there are real effects of budget deficits on the economy.

In the preceding chapters, the structure of general balance of public sector for the period of 1982-1997 and the structure of the budget of the TRNC for the period of 1977-1997 have been analysed. Factors creating the budget deficits in the TRNC, form of financing the budget deficits and the effects they create on the economy have been discussed in detail. The results obtained are summarized below.

Transfers, as an element of public expenditures, have been effective in the high share of public expenditures and have been a determinative issue in maintaining the existence of public savings deficit for the period of 1982-1997. Public revenues have increased and public deficit has decreased during the period under consideration. The rate of increase of current expenditures plus transfers have been higher than the rate of increase of public fixed capital investments during the period with a large difference between the two. The structure and development of public expenditures in the TRNC have contributed the improvement of capital stock at very limited ratios during the period of 1982-1997. The state has reserved fewer shares for investments and more importance is attached to transfers during the period. Especially, the high share and direction of development of transfers which are not in return of production and services have shown that the TRNC is deviating from the effective use of the public resources. Privatisation has started but not completed yet, but the high burden of Public Economic Enterprises has continued during the period of 1982-1997. Public revenues have increased at the expense of increasing the tax burden and restricting the investments during the period; but the aims of reducing the public expenditures and increasing the public investments in order to establish a more efficient public sector and a just tax structure has not been achieved during the period of 1982-1997.

Budget is an important policy tool for directing and controlling the economy of the TRNC. The TRNC is experiencing structural problems accumulated throughout the years since its establishment. The structural problems lead to the budget deficits in the country. Current expenditures, especially personnel and transfer payments are the main elements, which have lead to the budget deficits during the period 1977-1997. Another factor in the creation of budget deficits is losses of Public Economic Enterprises which are financed by borrowing during the period. Although by the application of VAT (Value Added Tax) in 1996 some positive effects were recorded, an efficient tax assessment and collecting system and an effective tax management could not be established during the period. The coverage of taxation could not be expanded, tax losses could not be reduced and justice could not be established during the period of 1977-1997.

Borrowing and aids from Turkey mainly have financed the deficits of the budgets and the borrowing from Turkey has never been paid back. There has been borrowing by the Treasury Department of the State from the Central Bank for meeting the current expenditure deficits and the losses of the Public Corporations and Institutions during the period of 1977-1997. Funds have imposed on goods and services in the country during the period and borrowing of the Treasury from the Central Bank is done from the funds account.

Since the larger portion of the budget deficits are financed by loans and aids from Turkey and a smaller portion is financed by domestic borrowing as explained, it is not possible to say that the main reason for the high interest rates is the domestic borrowing of the state from the Central Bank. There might be slight influence due to the domestic borrowing. It is obvious that the main reason for the high interest rates is the imported inflation since the Turkish Lira is used as legal tender.

External saving is still an important issue in setting the Investment-Saving balance since domestic savings are insufficient in meeting the investments in the TRNC. Propensity to invest is at a low level while private savings could not be converted into investments during the period under consideration. This seems to be one of the main problems of the TRNC. Increase in public deficits created a negative effect on the manufacturing industry for the period of 1977-1997. Transfers from private savings are directed to unproductive fields instead of directing them to investments because of public and budget deficits. Thus, increases in public and budget deficits have created a crowding out effect on the manufacturing industry investments during the period of 1977-1997. This situation creates some negative problems on the restructuring of the economy of the TRNC.

Domestic borrowing of the state of the TRNC has increased in the period of 1992-1997. The share of the public sector from the financial resources lent by both the Central Bank (own resources) and by the whole banking sector (including the commercial banks) has been very high for the period. Current expenditures of the public sector together with the losses of Public Corporations and institutions have been financed at the expense of restricting the financial opportunities for the private sector for the period of 1992-1997. Therefore, financial crowding out has created as a result of financing the budget deficits in the TRNC for the period under consideration. This result shows that the crowding out hypothesis of the neo-classical approach in theory holds for the case in the TRNC.

b) Recommendation

Within the frame of the analysis done, some policy recommendations for minimizing the negative effects of budget deficits on the economy, public and private sector capital stock in the TRNC are considered below.

Considering the present circumstances, until a specific development level is attained, it will be useful to develop a policy in order to increase the external savings together with the domestic savings. Because, the increase in external savings will cause an increase in the resources that can be directed to investments.

While the resources of the economy can not be converted into investments, the use of external resources for the economy still exists. These two important problems are determinative in the improvement of the economy in the TRNC. Overcoming these problems depends on accelerating the potential savings and directing them to investments. For this purpose "hidden" and "sheltered" resources should be explored and necessary measures should be taken for this. Basic rule in the success for improving a county's economy is to fill the gap between the potential and real investments gradually. The fact that creating resources itself will not solve the problem should not be forgotten. Besides the inadequacy of savings, employment of the limited resources to unproductive fields is one of the problems that prevent the economic developments in the TRNC. The objective should be to direct the public and private investments to productive fields. Because of this, the investment and encouragement polices that will be followed should be motivating for the entrepreneurs and a climate for investments should be created. One of the basic objectives is to realize the economic development speedily and in stability. Because of this setting up the balance between the demand and supply is very important. Prerequisite for the setting up of this balance is to realize the balance between the planned investments and savings. Therefore, the main policies that should be followed in the TRNC must be directed in order to set this balance.

When we consider the structure of the public expenditures in the TRNC we see that the contribution of these expenditures to the increase of production and to the creation of employment is very limited. Especially the large volume and development direction of transfer expenditures shows that the state of the TRNC is away from the effective use of public resources. Considering the above situation, there is a need for the application of a fiscal policy that will improve the income resources and the expenditure policies in the TRNC must be revised. Because, like in all developing economies, sensitivity of the TRNC economy to money resources is increasing and the economic developments are directed by money. The State directs the money resources through its institutions, and these institutions have the tools for directing the money resources. Fiscal policy helps these institutions to co-ordinate and to use these tools in integrity. Therefore it is inevitable for the state of the TRNC to apply a fiscal policy that will be supported by the measures for directing the limited resources to the most productive areas and by the establishment and management of an effective taxation system. But if as in the present structure most of the collected resources are directed to consumption but not to investments, it will be very difficult to restructure the economy of the TRNC.

Budget deficits occur as one of the most serious problems of the economy of the TRNC. For reducing the burden of the budget deficits on the economy, budget deficits should be brought under control. For this purpose, on one hand while limiting the increase in the budget expenditures in a discipline, on the other hand, minimizing the tax losses should increase tax revenues. It is obvious that, budget deficits are formed as a result of the increase in public expenditures, especially the personnel expenditures (wages and salaries), and as a result of the transfer expenditures. But the main problem is the insufficient increase in the public revenues for counterbalancing the present share of the state in the economy and the economic growth: High share in the economy, high level of expenditures and low level of revenues. Because of this, there is a need for converting the potential savings into real savings and the main resource for this purpose is the potential taxes. Therefore, there is an urgent need for a tax reform, which will include the reorganization of the tax management in the TRNC. Restructuring of the tax system main aims should be to provide additional revenues and to provide the just distribution of taxation. Reducing the tax losses should expand taxation coverage. Considering that tax systems are also the application tools for economic and social policies, tax regulations should be in a direction in order to encourage savings and the conversion of savings into investments. For this purpose, by imposing less or no taxes for the share of income that will be transferred to savings or investments, production and employment might be increased. Tax regulations should be in such a way to encourage the institutionalizsation of the firms so that the economic powers will not be dispersed. This will increase the competition capacity of the TRNC.

The high burden of Public Economic Enterprises is still a serious problem for the economy of the TRNC although privatisation is in progress. Privatisation must be completed urgently for the best result.

Social Security reform has not been started yet although discussions are still continuing about a draft law. By this reform, the imbalance between the private and state employees will be removed, while on the other hand, the burden of the retirement payments on the budget will be reduced (as stated in the Turkey-TRNC economic co-operation protocol). This reform should be completed urgently.

Education policies and investments on education should be so organised in order to help the formation of qualitative man-power who will consider the economic requirements of the TRNC.

While improving the human resources by education, health polices which will prevent the waste of human resources must be implemented.

With a structurally healthy budget, economic developments of the TRNC will be realized more rationally and a strong socio-economic system will be established.

BIBLIOGRAPHY

Akdoğan, A. *Kamu Maliyesi*, Ankara: Gazi Kitabevi, 1997.

Aksoy, Ş. *Kamu Maliyesi*, Istanbul: Filiz Kitabevi, 1998.

Altuğ, O. *Kayıtdışı Ekonomi*, Istanbul: Cem Ofset, 1994.

Anadolu Üniversitesi, *Türkiye Ekonomisi (Ünite 1-10), No:829*, TC AÜ Yayınları Eskişehir: Anadolu Üniversitesi Matbaa Tesisleri, 1994.

Anadolu Üniversitesi, *Türkiye Ekonomisi (Ünite 1-10), No:119*, TC AÜ Yayınları Eskişehir: Web Ofset, 1993.

Anadolu Üniversitesi, *Devlet Bütçesi (Ünite 1-13), No:23*, TC AÜ Yayınları Eskişehir: Web Ofset, 1993.

Anadolu Üniversitesi, *Kamu Maliyesi (Ünite 1-13), No:41*, TC AÜ Yayınları Eskişehir: Web Ofset, 1993.

Ataç, B. *Maliye Politikası*, Eskişehir: Etam A.Ş. , 1997

Avrupa Toplulukları Komisyonu, *Türkiye Ekonomisi Yapısı ve Gelişimi*, Brussles: Türkiye-Avrupa Topluluğu Derneği, 1989.

Besim, M. *Evolution of Public Finance and the Black Economy in the TRNC*, Master's Thesis, Gazi Mağusa: Department of Economics, EMU, 1995.

Bıçak, H and Altınay, M. *Restructuring of the Northern Cyprus Economy, No:95/3*, Working Paper EMU, 1995.

Bulunç, A. *KKTC Ekonomisi Makro Dengeleri*. Istanbul: İktisadi Araştırmalar Vakfı, 1993.

Bulunç, A. *Public Debt, Problems it Creates and Crowding out,* (Unpublished) Gazi Mağusa : EMU, 1995.

Central Bank of the Turkish Republic of Northern Cyprus, *Bulletin, No:22,* Lefkoşa: 1994.

Central Bank of the Turkish Republic of Northern Cyprus, *Bulletin, No:23,* Lefkoşa: 1995.

Central Bank of the Turkish Republic of Northern Cyprus, *Bulletin, No:24,* Lefkoşa: 1996.

Central Bank of the Turkish Republic of Northern Cyprus, *Bulletin, No:25,* Lefkoşa: 1997.

Central Bank of the Turkish Republic of Northern Cyprus, *Bulletin, No:26,* Lefkoşa: 1998.

Damodar,G. *Essentials of Econometrics,* United States of America: McGraw-Hill, 1992.

Dorfman, R. *Measuring Benefits of Government Investments,* Washigton D.C. : The Bookings Institution, 1963.

Dornbush, R and Fischer, S. *Macroeconomics.* 6 th ed. Singapore: McGraw-Hill, 1994.

Eckstein, O. *Public Finance.* 4 th ed. New Jersey: Prentice-Hall, 1979.

Edizdoğan, N. *Kamu Maliyesi 2,* Bursa: Ekin Kitabevi,1994.

Edizdoğan, N. *Kamu Maliyesi,* Bursa: Ekin Kitabevi,1995.

EGİAD, *Türk Vergi Sisteminde Sorunlar ve Çözüm Önerileri, Ekonomik Raporlar No:7*, İzmir: 1992.

Erginay, A. *Kamu Maliyesi*, Ankara: Savaş Yayınları, 1994.

Eroğlu, A. *Bütçe Açığı-Cari İşlemler Açığı İlişkisi: Türkiye Üzerine Bir Denenme*, Ankara: DPT Yayını, 1998.

Ertek, T. *Ekonometriye Giriş*. First Ed. İstanbul: 1996.

Gönül, A. *Bütçe Açıklarının Finansmanı ve Ekonomik Etkileri*, Ankara: DPT Yayını, 1998.

Gürsoy, B. *Kamusal Maliye*, Ankara: AÜ SBF Yayını, 1978.

Kıbrıs Türk Federe Devleti, *Birinci-Beş-Yıllık Kalkınma Planı (1978-1982)*, Lefkoşa, 1992.

KKTC Başbakanlık DPÖ, *İkinci-Beş-Yıllık Kalkınma Planı (1988-1992)*, Lefkoşa, 1988.

KKTC Başbakanlık DPÖ, *Üçüncü-Beş-Yıllık Kalkınma Planı (1993-1997)*, Lefkoşa, 1992.

KKTC Başbakanlık DPÖ, *Üçüncü Beş Yıllık Kalkınma Planı Stratejisi, Amaçları, Makro Hedef ve Dengeleri*, Lefkoşa, 1992.

KKTC Devlet Bakanlığı ve Başbakan Yardımcılığı DPÖ, *1995 Yılı Programı*, Lefkoşa, 1994.

KKTC Devlet Bakanlığı ve Başbakan Yardımcılığı DPÖ, *1995 Yılı İcra Planı*, Lefkoşa, 1994.

KKTC Devlet Bakanlığı ve Başbakan Yardımcılığı DPÖ, *1996 Yılı Programı*, Lefkoşa, 1996.

KKTC Başbakanlık DPÖ, 1997 Yılı Programı, Lefkoşa, 1996.

KKTC Başbakanlık DPÖ, *Statistical Yearbook*, Lefkoşa, 1997.

KKTC Başbakanlık DPÖ, *1998 Geçiş Yılı Programı*, Lefkoşa, 1997.

KKTC Başbakanlık DPÖ, *1999 Geçiş Yılı Programı*, Lefkoşa, 1998.

KKTC Başbakanlık DPÖ, *Ekonomik ve Sosyal Göstergeler*, Lefkoşa, 1998.

KKTC Ekonomi ve Maliye Bakanlığı, *Mali Rapor*, Lefkoşa, 1976.

KKTC Ekonomi ve Maliye Bakanlığı, *KKTC 1995 Mali Yılı Bütçe Tasarısı*, Lefkoşa, 1994.

KKTC Ekonomi ve Maliye Bakanlığı, *1995 Mali Yılı Bütçesi*, Lefkoşa, 1994.

KKTC Ekonomi ve Maliye Bakanlığı, *1994 Mali Yılı Raporu*, Lefkoşa, 1995.

Musgrave, R. *Public Finance In Theory and Practice*. 5 th ed. Singapore: McGraw-Hill, 1989.

Musgrave, R. *Maliye Politikası*, İstanbul: Marmara Üniversitesi Yayını, 1987.

Musgrave, R. *The Theory Of Public Finance*, U.S.A.: McGraw-Hill, 1959.

Orhaner, E. *Kamu Maliyesi*, Ankara: Gazi Kitabevi, 1997.

Orhan, O. *Türkiye'de Bütçe ve Maliye Politikaları*, İstanbul: İTO Yayını, 1994.

Önder, İ. *Türkiye'de Kamu Maliyesi, Finansal Yapı Ve Politikalar,* İstanbul: Tarih Vakfı Yurt Yayınları, 1993.

Özbilgen, Ş. *Maliye Politikası,* Bursa: Ezgi Kitabevi, 1998.

Parasız, İ. *Monetarizim ve Ünlü Monetarist ve Keynesgil İktisatçılarla Söyleşiler,* Bursa: Ezgi Kitabevi, 1996.

Parasız, İ. *Kriz Ekonomisi,* Bursa: Ezgi Kitabevi, 1995.

Rosen, H. *Public Finance.* 4 th ed. U.S.A.: Irwin, 1995

Saydam, G. *KKTC'de Uygulanan Vergi Politikaları,* Gazi Mağusa: Maliye Politikaları ve Kuzey Kıbrıs Ekonomisi Sempozyumu (Unpublished), 1998.

Seyidoğlu, H. *Uluslararası Finans* , İstanbul: Güzem Yayınları, 1994.

Türk, İ. *Kamu Maliyesi,* Ankara:Turhan Kitabevi, 1996.

Türk, İ. *Maliye Politikası,* Ankara: Turhan Kitabevi, 1998.

T.C. Başbakanlık DPT, *Türkiye'de Gelir ve Kurumlar Vergisi Yapısının Değerlendirilmesi,* Ankara, 1994.

T.C. Başbakanlık Hazine Müsteşarlığı, *Ekonomik Kavramlar ve Göstergeler,* Ankara, 1997.

Uğural, Ç. KKTC Mali Yapısının Analizi ve Enflasyon, Lefkoşa, 1993.